JOINT MANUFACTURING OPPORTUNITIES FOR SMALL BUSINESS: HOW HIGH THE BARRIERS?

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, IMPACT OF DEREGULATION, AND PRIVATIZATION

AND THE

SUBCOMMITTEE ON REGULATION, BUSINESS OPPORTUNITIES, AND ENERGY

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

WASHINGTON, DC, FEBRUARY 27, 1989

Printed for the use of the Committee on Small Business

Serial No. 101-4

U.S. GOVERNMENT PRINTING OFFICE

99-499 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

H721-31

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JOINT MANUFACTURING OPPORTUNITIES FOR SMALL BUSINESS: HOW HIGH THE BARRIERS?

MONDAY, FEBRUARY 27, 1989

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATION, BUSINESS OPPORTUNITIES, AND ENERGY, AND SUBCOMMITTEE ON ANTITRUST, IMPACT OF DEREGULATION, AND PRIVATIZATION,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The subcommittees met jointly at 10:00 a.m., in room 2359–A, Rayburn House Office Building, Hon. Ron Wyden (chairman of the subcommittee) presiding.

Chairman WYDEN. The hearing will come to order.

Good morning. Today, the Subcommittee on Regulation, Business Opportunities, and Energy holds its second hearing on the subject of flexible manufacturing networks.

I am particularly pleased today's hearing is a joint session including the Subcommittee on Antitrust and Deregulation, chaired by my good friend, Dennis Eckart of Ohio. It is a pleasure to be able to team up with Dennis. We served together as seat-mates on the Energy and Commerce Committee and as subcommittee chairmen on Small Business. It is a pleasure to pursue this issue with him.

Now flex-manufacturing may not yet be a familiar term on daytime TV, but it may well create a revolutionary breakthrough for our small companies in fighting back against European and Japanese competition.

Flex-manufacturing means informal partnerships—letting companies share resources, including plant and equipment, and jointly purchase raw materials. Flex-manufacturing means cooperation among our companies, in training their employees, and for joint marketing and market development.

At our first hearing last September, we heard European industry witnesses describe this sort of cooperative agreement, often between competitors, as normal operating procedure. If I may quote from this morning's Wall Street Journal on the subject, this sort of collaboration has made manufacturers as diverse as furniture makers in Denmark to tooling companies in northern Italy "faster, more flexible, and more competitive."

Witnesses from a number of U.S. industrial sectors said they were anxious to use these methods, to give themselves a fighting chance in both domestic and international markets which current-

ly are dominated by foreign suppliers. But there is a mighty big obstacle in their path—the Clayton Act.

Our 75-year-old antitrust laws and their application create much anxiety for manufacturers—even the smallest tool and die shop—who see flexible manufacturing networks as their life-ring. Certainly, the possibility of treble damages and jail terms have a sobering effect for those who enter what may be inappropriately described collusive agreements.

Far more sobering to me is the bad news that at present we are losing 100,000 American manufacturing jobs per year in bread-and-butter industries, as nations with flexible systems continue to gain new jobs.

That is why I drafted H.R. 423, the Joint Manufacturing Opportunities Act of 1989, a bill I introduced last month, and which now has over 30 cosponsors. This bill does one thing, and one thing only: It reduces the horse-and-buggy application of our 75-year-old antitrust statutes, limiting enforcement to vital issues, such as price fixing, and allowing U.S. companies to do what they do best—compete.

This bill is about enhanced efficiencies, better products, and lower consumer prices. It is about jobs, and it is about giving our private sector the tools which eventually will whittle down two looming deficits—trade and the Federal budget—which threaten this country's economic future.

What I like particularly about this initiative is that it can be a jobs program without adding to the Federal deficit, without the use of additional tax dollars.

Since this bill does lead us into the somewhat treacherous waters of antitrust law, I am most pleased to be sharing the hearing today with the Subcommittee on Antitrust, Deregulation, and Privatization. I should point out that Mr. Eckart was one of the original cosponsors of H.R. 423, and I would like to thank him and his staff for the tremendous support they have been in today's hearing.

Ours is a very simple bill. Following the example of the National Cooperative Research Act of 1984, it directs courts to use a rule-of-reason in determining if cooperative manufacturing agreements are anticompetitive. There is no safe haven in our legislation. There is a 500-employee ceiling for individual companies desiring to enter these networks, and no network can absorb more than 20 percent of its relevant market.

Rules of entry are simple and direct and can be negotiated quickly and without legions of lawyers. Despite our prequalifications, we believe that the vast majority of U.S. manufacturers will be able to use these systems.

In a number of instances, U.S. industry already has begun making tentative steps into flexible networking, picking up pieces of the puzzle:

One, in the last 10 years, the average investment of U.S. tool and die makers in their basic machine shop has risen, on the average, from $100,000 to almost $2.5 million. In Meadville, PA, tooling companies are attempting to fight back those costs by establishing a shared-teaching factory, with state-of-the-art computerized equipment, to be used by a number of companies.

Two, in Columbia Falls, MT, wood products manufacturers will produce cabinetry and other wood products in a shared shop. These are very small companies, with only a handful of employees each. By banding together in this way, they hope to buy the equipment that can cost a quarter million dollars per copy.

Three, in Flint River, MI, automotive part manufacturers are looking for new markets and new customers, particularly in defense fields, "with shared-manufacturing and shared-brain power," according to the project's director.

These are all worthy ventures, and they indicate a resurgence in the Yankee ingenuity that helped this country become an industrial giant 100 years ago. But in comparison to the activity and quality of European and Japanese networks—the same networks that are beating our brains out in so many domestic markets—we have a long way to go. H.R. 423 gives our incipient network ventures an extra shot in the arm.

So, the question we have today as we look to key administration witnesses, those involved in these important issues, including Mr. Charles Rule of the Justice Department's Antitrust Division, and others, is why not? Why not go forward with this important new economic development tool and move just as expeditiously as possible?

I want to recognize my colleagues for their opening statements, and then we will proceed with our witnesses. Congressman Eckart.

Chairman ECKART. My thanks to you, Ron, and to our colleagues and staff for helping with this hearing. I, too, like my colleagues, have witnessed the egression of hundreds of thousands of Northern Ohio jobs over the last decade. It seems that, in a wide variety of circumstances, we have forced some of our smallest businesses to compete with one hand tied behind their backs.

The antitrust law's prohibition, forbidding joint manufacturing networks, is a self-imposed competitive disadvantage, which I don't think we can any longer afford to ignore. I think both consumers and the private industry can and will benefit from the enactment of legislation.

All too often small business assistance has been defined as programs of grants or loans, the efficaciousness of which is certainly suspect, at least in this gentleman's view. I view these legislative initiatives as a different form of small business assistance, perhaps the beneficence of deregulation in the correct direction.

That is why we are delighted to participate and to support these efforts. We look very much forward to the administration's suggestions. Our colleagues from California and Virginia have also introduced somewhat different bills in this matter. We would hope, as a result of these hearings' progress, that stimulation of interest and a further awareness in the small business community will emerge. They need to be aware that this is a legislative initiative of great value to them so that when they lobby us, as they can so effectively, on matters such as a section 89 and a few other items of interest, Congress' attention will be devoted to this issue as well.

I am grateful to the witnesses for taking some time to be with us this morning. I welcome this opportunity, and I can assure you that, at least from this gentleman's perspective, we really would

like to make a dent in this area and move this issue forward. Thank you.

Chairman WYDEN. I thank my colleague and, again, thank him for all his help.

The gentleman from Massachusetts, Mr. Neal.

Mr. NEAL. I don't have anything, Mr. Chairman.

Chairman WYDEN. The gentleman from Nevada.

Mr. BILBRAY. Mr. Chairman, H.R. 423, the Joint manufacturing Opportunities act of 1989, is a bill that is desperately needed to spur a resurgence of our country's manufacturing industry.

Joint manufacturing networks have proven their effectiveness in Europe, and, if the U.S. fails to enact similar measures for their struggling industrial sectors, we will fall hopelessly behind in the ever competitive world industrial market.

I am specifically interested in the impact H.R. 423 would have on the faltering electronics industry in our country. I think it would be a boon for our country in the race to develop high definition television, a race we are currently losing to the Japanese.

Mr. Chairman, joint manufacturing ventures are a needed step in the process of recovering the 700,000 manufacturing jobs lost since 1981. I am proud to be a cosponsor of H.R. 423, and I urge the rest of my colleagues to join me in supporting this important piece of legislation. Thank you.

Chairman WYDEN. I thank my colleague for his statement and his support of the legislation as well.

Gentlemen, we welcome you. We thank you for your patience. It is the practice of this subcommittee to swear all witnesses. Do any of you have any objection to being sworn?

[Witnesses sworn.]

Chairman WYDEN. We will make a copy of your prepared remarks a part of the hearing record in their entirety. If you could summarize your views in 5 minutes or so, that would help us to stay on track. But we thank you for your assistance and note that all of you have had a long-standing interest in this. Why don't we begin with you, Mr. Rule.

TESTIMONY OF CHARLES F. RULE, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. RULE. Thank you, Mr. Chairman. Thank you, Chairman Eckart and members of the subcommittee. It is truly an honor to be here this morning to talk about this important legislation, and I commend these subcommittees of this committee and others in Congress for addressing this important issue.

Let me say at the outset that although my department, and in particular the Attorney General, has made it clear that we believe some legislation to remove antitrust obstacles to needed beneficial joint production ventures should be passed, the administration has not yet taken a position on whether or in what form such legislation should be enacted.

It strikes me that there are really two reasons that your work here today is so important. First of all, over the last decade, we witnessed a rapid increase in the rate of technological change. That has increased the risks associated with trying to bring new technol-

ogies to the market because of the risk that they may quickly be displaced by unique technologies.

It also has increased the potential efficiencies and economies that can be obtained if the bringing of those technologies to the market is done in the right way; that is, economies of scale, economies of scope, limitations of risk, and that sort of thing, synergies that otherwise might be available.

It is important that in order to take advantage of those economies and to, in effect, pool risk, cooperative ventures are often essential.

The second real change that has occurred over the last 10 years that makes your work so important is the increased presence of foreign companies. This change is relevant in two ways. First of all, as has been stated, I think, so clearly and effectively here this morning, that has meant that foreign firms, able to get together in joint ventures have, in effect, stolen a march on American companies and been able to compete more effectively and, frankly, take business away from American firms, and as a result we have seen some jobs lost.

The other, and perhaps more relevant to me as an antitrust enforcer and those of us in the community, is that the presence of foreign firms means that it is far less likely today than perhaps it would have been 10 years ago or 15 years ago that cooperative efforts among American companies is going to hurt American consumers. If American firms get together in joint ventures to take advantage of these technological changes and they try to, in effect, raise prices or restrict output, there will be plenty of foreign firms there to penalize them and to protect the interest of consumers. So, in a way, there is a market influence that will protect consumers, and it means we can take a more flexible approach, I think, to the antitrust laws.

We in the Department of Justice have tried to do our part to make the antitrust climate more hospitable to joint production ventures. We recently published the antitrust enforcement guidelines for international operations. The centerpiece of those guidelines is an explication of a flexible approach that we take toward joint ventures, including joint production ventures.

But the fact is that American antitrust laws are enforced not just by the Federal Government but by private individuals in the States as well. Those guidelines can only bind us—not the courts, not private parties.

Therefore, the risk that, in effect, once a very effective, very successful joint venture is formed, disgruntled competitors, disgruntled consumers, or someone will sue and try to hold up the joint ventures appears to be a risk many firms are unwilling to take in terms of joint production. It is certainly something we have heard over time.

There are a number of areas where I know a number of people, both in and out of Government, view cooperative efforts as being particularly important, like flexible manufacturing. Semiconductors is probably another, and superconductors, over time, will probably be a fourth.

Thus, if we are going to encourage those kinds of ventures and allow them to go forward in the absence of antitrust risks or at

least deal with the antitrust risk problem, some legislation probably needs to take place. There really are two alternatives. The first is referred to as the certification process, which I guess is best exemplified by what I will call the Boucher-Campbell bill recently introduced. That would involve the filing of a great deal of information about a proposed venture and certification or approval of that joint venture by the Department of Justice, FTC, and in concert with the Commerce Department.

If, after a thorough analysis, there was a conclusion the joint venture would not harm competition or that any threat to competition was outweighed by procompetitive benefits, the joint venture would be approved, and it would have immunity from everything except, perhaps, injunctive suit and criminal action for at least a period of 17 years.

Clearly, the upside of that approach is it gives a great deal of certainty. It is pretty clear if you are certified conduct, you are not going to be challenged. The downside is that it tends to involve a great deal of Government scrutiny, a great deal of Government involvement to some extent in the structuring, which may lead to less flexibility in the formation of joint ventures. It also, frankly, will require more resources in terms of dealing with both on the part of Government and perhaps the private sector.

The second approach, which I will call the notification approach and is perhaps best represented by H.R. 423, which you, Mr. Chairman, have introduced and many have signed on, as you mentioned, creates or provides less certainty than a certification approach because, as you know, under the notification approach part—first off, the law has made clear that joint production ventures cannot be automatically condemned. They can only be condemned after a sensitive rule of reason approach is applied, and for those ventures that are notified to the Government, there is the limitation on damages to actual damages plus interest. This is an approach that was taken in 1984 in the National Cooperative Research Act and, in my opinion, has been very successful, for example, in giving comfort to the semitech joint venture, giving comfort to those who, IBM and others, have gotten together to develop a competing operating system to UNEX and others.

Both approaches, in my opinion, will adequately protect consumers and will adequately protect the interests that we in the Antitrust Division are concerned about. So either, from that standpoint, is probably acceptable.

I think the question before the subcommittees, then, is which will be most desirable, most effective in accomplishing the ends you want to accomplish? That is, which would users prefer? There is really a tradeoff, and, obviously my Department wants to work very closely as those developments take place. We want to help make sure we get good legislation, and, assuming that the administration ultimately signs on, we can get it enacted quickly.

But I think that the place to look for which way we ought to go is to the business community that we expect to use this legislation.

Thank you, Mr. Chairman, and I look forward to your questions.

Chairman WYDEN. Thank you very much for an excellent and short statement.

[Mr. Rule's statement may be found in the appendix.]

Chairman WYDEN. Mr. Swain, we welcome you.

TESTIMONY OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. SWAIN. Thank you, Mr. Chairman.

I, too, wish to express my appreciation to your subcommittees for taking an interest in what I clearly think is one of the more important matters on the small business agenda, notwithstanding the fact that it is not a subject of day-to-day volumes of mail to your offices. That is not to imply those other subjects are not important, but I think this is a future-oriented issue.

I do think that the committee is focused on the right place, in the sense that small manufacturers have shown extraordinary economic resilience and technological capability over the last several years. It is true that we have seen an overall decline in the course of manufacturing employment in the United States, but we are pleased to note even while that was taking place, the amount of manufacturing employment among smaller firms has been increasing.

We also have other studies which indicate that clearly the technological and innovative brain power of small firms is highly significant. Small firms, according to a number of studies, tend to be more highly innovative than their larger counterparts. Obviously, the point is, if they are innovative in coming up with the inventions in the first place, they ought to be equally innovative in coming up with the manufacturing processes to bring these inventions and techniques to the attention of industrial consumers and users.

Unfortunately, that has not been the case. A study that we note in our statement, along with several other studies that have been noted in other hearings, indicate the general record of the United States on installation of flexible manufacturing systems trails other highly industrial countries, particularly Japan and Sweden.

That is not surprising, particularly from the perspective of small business. Small businesses are not usually endowed with adequate amounts of capital to engage in the financing that might necessarily be appropriate to installation of these systems.

I hasten to add that I am not implying that some sort of new SBA loan program for flexible manufacturing ought to be created. I am simply suggesting that there are some national barriers to producing flexible manufacturing systems among industries in general, barriers which are much more severe among small firms. Therefore, we do feel any assistance that the Congress can give certainly goes in the right direction at this juncture.

There are some programs currently being pursued by the Federal Government, most particularly by the National Institute of Standards and Technology. I am sure Mr. Brumley can address himself to those. They have a couple of new programs that seek to create diffusion of manufacturing technologies, including one based in Cleveland, as you certainly know, Mr. Chairman.

In addition, the U.S. Small Business Administration is currently seeking to emphasize among its small business development centers that they have a role in technology transfer and diffusion, so,

we can make sure that local delivery mechanisms that are already in place are open to manufacturing technology exchange. This may or may not be the case now, although I am pleased to say that in a preliminary survey that we have done, well over half of the small business development centers report some sort of programs in the technology diffusion arena.

I think it is most important to point out, as Mr. Rule did, that if this legislation or a similar legislation is passed, it will probably not instantaneously mean a lot of new flexible manufacturing systems are created that were not created before.

But it seems to me that in order for there to be any strong drive toward flexible manufacturing, it is absolutely necessary that the Congress tone down the potential antitrust difficulties that a business owner, seeking to invest his or her time and engage in negotiations with their colleagues, faces. Business owners have been raised for several generations to avoid talking to one's colleagues about production and costs, and flexible manufacturing requires that to be done.

I won't try to comment on the technical rules as they stand now or as they might be under various proposals, Mr. Chairman. I do think that the Congress needs to give a signal to the business community that if for financial and technological reasons it is important to get together to share production, then there won't be antitrust violations. That is a very clear and simple signal that I believe needs to be sent by the Congress, so we strongly endorse pursuing this type of legislation.

I will note one thing: SBA has limited experience with an analogous situation. As you may know, there is a provision in the Small Business Administration Act that allows companies, small companies, who meet the SBA standards to bind together to create cooperative ventures for purposes of pursuing contracts with the Department of Defense. You may not know about it because it has never been used. It has been in the law for about 30 years.

To the best of our knowledge, there is only one such consortium that has ever sought permission under that provision of law. It received permission in the early 1980's, and to my knowledge that consortium has not been successful in actually receiving any Government contracts. There may be many reasons for that. I know that one reason is that it was very difficult for the group of seven or eight small firms to stay together; just the corporate mechanics of staying together makes it difficult. A second reason was that the process, which I think in using Mr. Rule's hierarchy fits a certification approach, requires the filing of a lot of papers with the Government. They must be approved in series by SBA, and then by the Justice Department, and then by the Federal Trade Commission. That process proved more cumbersome and expensive than it needed to be.

So, I would suggest, as the Congress and administration flesh out an appropriate procedure, the procedure should be as simple and straight forward as possible, and look to the average business owner like one that he or she can make it through so as to produce whatever they are going to produce rather than fooling around with the Government and the private lawyers.

Thank you, Mr. Chairman. I would be happy to respond to any questions.

Chairman WYDEN. Thank you, Mr. Swain.

[Mr. Swain's statement may be found in the appendix.]

Chairman WYDEN. Mr. Brumley.

ROBERT H. BRUMLEY, PARTNER, HUNTON & WILLIAMS, AND FORMER DEPUTY GENERAL COUNSEL, U.S. COMMERCE DEPARTMENT

Mr. BRUMLEY. Thank you very much for the invitation to be here this morning, Chairman Eckart.

I guess Tom Landry and I have something in common; we are both former something's, at least as of today.

I especially appreciate the opportunity to be among my colleagues for the last time. An additional first is that for the first time since my Government career started, OMB didn't have to clear my testimony today.

Chairman WYDEN. You are a free man.

Mr. BRUMLEY. Yes; although the law firm told me not to embarrass it.

I think it is significant to note, from my experience for the past 6 years at the Commerce Department, there really is a first here.

The first, in a number of ways is, as of December 27, the Attorney General of the United States and a previous Secretary of Commerce, Bill Verity, agreed there needed to be some type of solution to a problem that the Nation's businessman brought to the Nation's lawyer. That problem was very well laid out, I believe, Mr. Chairman, by you, in assessing not only the loss of jobs, manufacturing jobs, loss of market share here in our domestic market, but also the need to do something that doesn't contribute to the budget deficit and something that we can do now.

Now, that should not take long in this Congress. It is a topic that has been discussed both in literature as well as, I believe, in the Congress as early as 4 or 5 years ago.

The concept of joint manufacturing exemptions from the antitrust laws is nothing new. But what is new and worthy of note here is that we have learned a lot about markets together. We have learned a lot about competition together. We have been through two trade bills together, not counting the two trade bills in the 1970's. Our market has been open for at least the last 8 years; open to foreign competition and to the dynamics of foreign competition and foreign trade.

As Mr. Rule has pointed out, there are a number of firms participating in our market. I note in my testimony that 75 to 80 percent of our manufactured products are under some form of import pressure right now.

We have learned a lot as to the dynamics of how competition works in our market. The Antitrust Division in its 1984 merger guidelines and most recently in its guidelines for international operations has, I think, clearly stated the lessons learned in the last 8 years.

Those lessons, in terms of how the market has developed and what has happened over the last 8 years, lead us to look for tools to

make both small business and all business as competitive as possible, not only as a substitute of our own products for those imported products and gain market share, but also to expand and begin exporting U.S. products to turn that trade deficit around.

As all good busifessmen know, and as Frank Swain has pointed out, there are a lot of components that go into being able to recapture that share of the U.S. market, capital formation being one, and the ability to achieve the most efficient cost factor in manufacturing a product domestically being another. Flexible manufacturing is an example of hgw companies can decide among themselves who their strategic partner should be, what they should bring together to make not only the most efficient product, but also to provide that product to outlets at the key point where you can get a return on investment before either the technology has been duplicated or pirated.

So, in learning about markets, we really need to add one other first, and that is, those at the Commerce Department have learned an enormous amount about technology. We have learned, as with markets, how the relationship of technology and technology development works—the role of Government in this relationship as an advocate for emerging technologies and as a watchdog for declines in technology; as a promoter of new technology; and, with regards to trade, the role technology plays in the market, as a key to maintaining market share as well as capturing market share overseas.

That lesson culminated in the recent establishment of the Technology Administration in the Department of Commerce, the establishment in which this committee of the House participated. You now have an advocate in the Department of Commerce for technology; for new technologies such as HDTV and its potential for new products. You also have a senior official in the Department looking for ways of stemming the decline of U.S. technology.

I note in my testimony, although I am not a physicist, I think matter is never in a state of rest, and, therefore, I ask you to consider technology the same way. Technology is either emerging or it is declining, but one thing for sure, it is always competing or being competed against.

Keeping that in mind, any solution that you seek, whether it be H.R. 423, or the Boucher-Campbell alternative, or an administration proposal, I set out three tests you should follow.

First, I learned from the late Mac Baldrige to keep it simple, make it a businessman's solution in a businessman's language. In fact, you shouldn't have to hire a number of antitrust lawyers to explain what the remedy is. The dynamics in the corporate board room, when putting a deal together, are so risky that anything can disrupt the transaction. If there is uncertainty in the understanding of the application of a new amendment to the antitrust laws, or uncertainty as to how far the exemption will go, or uncertainty as to the process in which you have to proceed, or extraordinary costs associated with it, you enhance business risk. Therefore, you have made the transaction or the culmination of the venture less attractive.

The second thing is, ensure it is complete. Apply your exemption evenly to all conceived lines of commerce. In other words, don't pick firm sizes; don't pick specific products to benefit; don't have

an exemption for certain kinds of technologies; or, Mr. Chairman, an exemption for certain sizes of companies.

Someone mentioned HDTV could possibly benefit from H.R. 423, but I think Zenith has more than 500 employees, and, if it has an interest in investing as a strategic partner, the benefits of H.R. 423 might not apply.

You want to encourage small business, and this committee should be complimented in the leadership it has taken in this area. But small business is relative—domestic small business you have drawn a line, but I have to say that since 1960, of the top 20 firms in the world, 13 of them were American; in 1986, 5 were American. Firm size is relative to the market of operations. If you are competing against Matsui or any of the large manufacturers soon to be in Europe in 1992, it is all relative.

Keep that in mind. Not only simplicity of the language and the process, but also that it should not be exclusive to any particular level or line of commerce or activity. Otherwise we raise an unnecessary barrier to some manufacturers.

Finally, and I think this almost goes without saying, it should do the job so that we don't have to be here in 2 or 3 years like we are now, following 5 years after the creation of the National Cooperative Research Act, recommending further legislative changes. We should project where we want to be in 1992, both competing with Japan, Inc., and the European Community, and the other new players in our market. We should project an exemption to our antitrust laws that will stand the test of time. If it needs to be changed, it should be changed through the public rulemaking process or effective guidelines program that the Antitrust Division has used to some extent in the past.

Rick Rule and I—well, I should say I agree completely with Rick's testimony as to the two alternatives. Somewhere in the middle will be the answer.

But I will give you one last note of a former administration official without OMB approved testimony, and that is usually the administration, the previous administration, would look at antitrust reform in terms of its legislative strategy, as a function of first convincing the Senate Judiciary Committee. We would seek leadership from that committee on the topic, and—I mean this affectionately, Mr. Chairman—then we plot to see how we roll the House. The House is viewed as a populous body that small business and other businesses look to to safeguard against changes to the antitrust laws unless they are well discussed, and the ramifications of such changes have been fully thought out.

You have turned the tables, Mr. Chairman, on the entire process. The House now has taken the leadership in this area. I don't believe the administration is going to be plotting to roll the Senate, but I think you have the leadership here, and I compliment you.

Thank you.

[Mr. Brumley's statement may be found in the appendix.]

Chairman WYDEN. Thank you very much, Mr. Brumley, particularly for your salute to the people's branch of the Government, and I want to thank all of you.

Before we go to questions, I want to recognize my colleague from California, who has a long-standing interest in legislation in this area, for any comments he would like to make.

Mr. CAMPBELL. Thank you. I apologize to you for being late. But for the Governor of California, I would have been here sooner.

I want to say at the start, this is a new incarnation but the same person, and I want to say hello to the usual suspects: Joe Sims, Charles Rule, Frank Swain, and Bob Brumley, as well as former FTC colleagues, Mr. James and others in the audience.

I applaud the chairmen for scheduling the hearings today.

I do like the dimensions of H.R. 423. I think it would be of benefit. I know our subcommittee will be focusing on the relative merits of different proposals. I recognize some of the testimony already has. That causes me to ask the subcommittee's attention to a brief memo which I submitted, identifying an amendment to the staff's side-by-side comparison of H.R. 423 and H.R. 1024, the latter being a bill I introduced with Congressman Rick Boucher, the gentleman from Virginia.

I think the desirability of any amendments to the antitrust laws is directly related to how businesses are likely to use them. So, we are looking for a simple system. We are looking for a fast track in some instances when that is appropriate, and to that end my memo identifies aspects of H.R. 1024 that lend themselves to the fast-track analysis.

In conclusion, Mr. Chairman, I look forward to working with you over the next 2 years in antitrust reform, and focusing on what small business can do to improve competition in the U.S. economy, and to follow the pattern I established in the first bill I introduced, and that is bipartisanship. I am proud to be the principal cosponsor with Rick Boucher.

Thank you, Mr. Chairman.

Chairman WYDEN. I thank my colleague. I am very much looking forward to working with him in this area. I think the gentleman shares my view that this is of importance to the economy.

I look forward to working with you.

Gentlemen, let me begin with a couple of questions.

The first thing, it seems to me, you have told us is of great importance, Mr. Rule, is that a new day has really dawned in antitrust law; that the climate is different than 100 years ago; that 100 years ago antitrust laws played a purpose primarily to protect the consumer.

Today, there is a different climate because of foreign competition. Is that correct?

Mr. RULE. Mr. Chairman, I think that is correct. There has been a great deal of change in the economy. To some extent it is a testament to the antitrust laws that they have been able to evolve along with the economy as well as they have.

We who enforce the laws have been able to adapt. Frankly, I think the courts deserve credit for bringing the antitrust laws in the latter part of the 20th Century, but the fact is you have a lot of courts out there, and even though the Supreme Court may ultimately get an issue right, the amount of time and money that would be expended in reaching that conclusion can often be very great and prohibitive.

The other fact is that the antitrust laws remedies really haven't been changed in that 100 years, and, probably more than anything else, it is those remedies that are chilling proper competitive joint ventures.

There are automatic treble damages available, plus attorneys' fees, for any plaintiff who succeeds in an antitrust trial. That is quite a sword to use against a company, the threat of that sort of suit, and it can be a very daunting obstacle to those getting together and risking a lot of money with the expectations they may see all that they accomplish and all the rewards they gain through treble damages.

Times have changed, and particularly that remedy hasn't, and there still is that uncertainty because of the number of courts and the time it takes, and, therefore, it is time, at least in this area, to bring the legislation up to date.

Chairman WYDEN. The issue that comes to my mind first when you compare the various kinds of approaches is, of course, to look whether there are similar models on the books and whether there are similar models that are working, because I think more than anything, we are trying to worship at one altar here, and that is to come up with something that is going to work in the business community.

One of the reasons I wrote H.R. 423 as I did is that it is patterned after the National Cooperative Research Act that I was also involved in, and that seems to have been a tremendous success. The business community has almost unanimously felt it was a great success. There have been more than 120 successful ventures.

Is there any reason at this point to assume that we couldn't use that same model which has been so successful with R&D, to use it in manufacturing?

Mr. RULE. Mr. Chairman, I don't know of any reason.

I am an antitrust lawyer and an antitrust official, and perhaps it is a paradox, me knowing anything about what businessmen perceive as in their interest. I don't know.

But I was very much involved in 1983–84 in the development of the National Cooperative Research Act, and that model, in effect, came out of that. That was sort of a development that occurred over time as we worked through that legislation. Frankly, those of us in the antitrust area never expected it to be anywhere nearly as successful as it has turned out to be, and I don't think any of my colleagues in the Department of Justice would have predicted the number of joint research and development ventures that have been notified to us.

So far as I know or believe, none of those have been anticompetitive, none of them have been challenged. There are some joint ventures that would have been thought impossible 5 years ago before we passed that legislation. I think it has been very successful. I personally see no reason why it can't be extended to production.

As you may know, Mr. Chairman, last year President Reagan, in conjunction with his superconductivity initiative, sent up a piece of legislation that, while written somewhat differently, would have largely accomplished the same end that H.R. 423 accomplishes. So, I think it could work, but, again, as I say, I enforce the law. It is

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probably business people who can better answer the question of whether it will be successful.

Chairman WYDEN. Just a couple of other questions for you, Mr. Rule, if I may. One of the other things that was striking to me about your testimony, and all of you have been quite praising of both bills, is your point that both bills would protect consumers, which is ultimately where the rubber hits the road.

That is what this issue is all about. If one takes that as the premise, that both bills would protect consumers, why not go forward with something like just notification rather than full-scale certification because notification will get you into the game quicker.

Mr. RULE. Well, there is certainly a good argument for that. Congressman Campbell, my old colleague, has presented a bill and told to some extent the other side of the story, which is the fact that certification provides increased certainty and less risk of a treble damage suit because there is no possible damage suit that is allowed under certification.

Certainly, that is an argument for certification, and where the ability to get into play quicker through notification plus what I would view as greater flexibility, resource requirement on the part of the Government outweighs that added certainty that is provided by certification is a question that I think is well worth the time of this committee and others in Congress to consider.

Chairman WYDEN. I want to ask one other question but pass something on to the administration by way of this issue.

The export trading company law is based on a certification model, and we have seen all kinds of problems with it.

My legislation goes to notification based on the National Cooperative Research Act, and it, according to all parties, is doing tremendously.

I hope that the administration will keep that in mind, again looking to two statutes where we do have a concrete track record before it takes a final position.

The last point that I wanted to ask is exactly what is taking place within the administration on this issue as far as whether we will get a concrete position or recommendation for a bill.

What is the administration game plan on this issue.

Mr. RULE. Well, Mr. Chairman, I think that obviously your department, not at the very top but at my level, the Commerce Department at various levels, and frankly all departments are in some fluctuation. I for example will be leaving very shortly.

My former colleague, Mr. Brumley, has recently left. So, I think that there is a view on the part, and a very responsible view I might add, on the part of the administration that we ought to figure out who the players are and once we have them in place, we can move forward on this.

I don't think though that means that I and those at Commerce can't work with the subcommittee in the interim to try to move the process along so that when those players are in place, something can be done very quickly.

I want to go back—this is a role that will make Mr. Brumley happy—to defend the ETC Act, and I think that in fairness it should be said too, the Commerce Department views the ETC Act

as having been a success, and that its implementation and administration has been a smooth one.

I think though that you are right, Mr. Chairman, in saying that is an appropriate model both in terms of what finally came out of the Congress in terms of legislation and in terms of how the two programs will work side by side.

I should also add that I frankly think, again in fairness, that it may be somewhat more difficult, more time-consuming, to address the competitive issues that are raised by joint productive ventures in a certification process than it has thus far been to address competition issues or issues that have arisen in the context of export-trading companies.

Chairman WYDEN. How many export-trading companies?

Mr. BRUMLEY. Last count we had over 500 firms who had sought ETC protection; 89 or 90 certificates granted.

In the time I have been at Commerce, we have not had problems with the ETC Act. Its protection is provided in consultation and concurrence with the Justice Department Antitrust Division.

We had one private suit that challenged the act which at the court of appeals level we won. That is the only problem area that we have come across.

Chairman WYDEN. I can tell you that a lot of people want to form these openings and are having great difficulty doing it. I know we are going to pursue this more as we go along.

Mr. Rule, there is nobody on board that is working on this issue? You and others at the Justice Department are about to leave, and there is nobody who is coordinating this effort at this point?

Mr. RULE. I want to make it clear, for example, that the Attorney General views this as a very important initiative.

He gave a speech last week to the Economic Club of New York, once again expressing the importance of this. I am talking to different groups to try to get input as to which is the most appropriate method, and we are here today, and we will be around to try to work with Congress and everyone else.

In fact, I will go back and see what we can do about speeding up the administration's process, and find out whether the administration wants to try to introduce its own legislation or simply work with Congress and what is there. It is just a fact of life that people are now in the process of background checks and everything else, and there is always a little bit of time to get those people on board.

That doesn't mean that we can't work along with the Commerce Department, and with this committee, and others to try to move the process along and get some legislation very quickly, because I don't know of resistance in the administration to coming up with good legislation to deal with this issue.

Chairman WYDEN. Who do we call, say in a week or 10 days in the administration?

Chairman ECKART. Call the White House switchboard.

Mr. RULE. I think it is fair to say, Mr. Chairman, that I will probably be there in a week or 10 days. But you can certainly call me or the people on my staff, Neil Roberts, for example, who has worked on the NCRA and ETC Act and will be working on this.

This is really an issue that the Attorney General has identified as one that is very important and that he is personally interested in. I think you can also call his staff.

Chairman WYDEN. The gentleman from Ohio.

Chairman ECKART. Mr. Rule, why won't the Department's guidelines that you mentioned be adequate to dispel the fear of litigation?

Mr. RULE. Well, the fact is, and I hope we made this eminently clear, our guidelines only affect our enforcement policy, and we, in fact, titled those guidelines the antitrust enforcement guidelines for international operations because they do only affect our enforcement.

In the past, we have been accused of incorrectly trying to influence the courts and decision in private cases through the articulation of our enforcement policy.

Frankly, we have tried to resist that accusation. As a practical matter, companies can go into court and cite those guidelines in support, but in the end, courts are free to reject them and interpret the Sherman Act as they see fit, or according to whatever precedents happen to be in their circuit, or however they read the Supreme Court.

Chairman ECKART. If this fails, what can Congress do?

Mr. RULE. There is something known as the business review process that enables companies to get a statement of current enforcement intervention of the Department of Justice, and some companies, if they want to get a sense of what the Department is doing, can do that.

It takes a long time, and most companies view it as being a time and expense that they would rather avoid and just rely on private counsel. I think we can continue to articulate our policy, try to make it as clear as possible, to the extent that there are private cases where it makes sense for us to go in as amicus and try to influence courts, but that is a slower process.

Chairman ECKART. You mentioned two proposals that are complementary. Let's let you sit up here, and you tell us how you might weave the two together to form a regulatory framework for joint ventures.

Mr. RULE. Let me first just clarify that statement. They can be complementary and woven together. There is a downside to weaving them together. There are a lot of issues here that you will have to deal with. The way you weave them together is the way that I read H.R. 1024 to try to weave them together, which is, although you could add something again to H.R. 1024, there is a section there that I think is designed to preclude per se treatment of joint production ventures regardless of whether they are certified.

I think that was the intention of that section. One could add an alternative track approach, that is, companies that simply wanted to notify and go forward could get relief from treble damages down to actual damages.

Those that wanted greater certainty could go for certification. The downside is that if you have—to some extent we discussed these issues in the context of the NCRA—if you have one system that provides certainty and approval there tends to be in the minds

of the courts, I think at times, a tendency to read the failure to get that approval negatively.

A failure to get certification as even though we put those provisions in the bill that say no we can draw evidentiary conclusions *from what the Government does* in this process, I think there is a natural tendency, a stronger impetus for companies to seek approval if that is there, because the only alternative may be risky in that a court is going to ask, "If this is OK, why didn't you seek approval," and, therefore, perhaps I will be a little suspicious.

That is my main concern, how those two regimes would interface. But there is nothing that says you can't have two alternatives available to companies, and, frankly, you just meld the two bills.

Chairman ECKART. So, obviously, you are spending some significant amount of time trying to decipher——

Mr. RULE. That statement was put in there to indicate that what the administration has said, what the Attorney General and Secretary have said about these being two alternatives does not necessarily mean they are mutually exclusive, and they might be woven together.

Where we are now is trying to get a sense from the user-community as to which is more user friendly—a computer word—and, hopefully, we will get some sense from that.

Frankly, at this point the information coming from the business community has been coming in dribs and drabs, and I don't have a sense at this point that, either as fully aware of the different alternatives, what the benefits and detriments are to each and come to some conclusion about which they would prefer or whether they would like to have both.

Chairman ECKART. Mr. Swain, it seems to me that you would be in a position to figure out which of these is user-friendly. Is the SBA involved in any way in figuring out how we make this user-friendly? It seems to me something should be done to represent the viewpoints of small businesses, and I understand that efforts by the appropriate Federal agencies to reach out to their constituencies are under way.

Tell me how you are trying to help make these proposals user-friendly.

Mr. SWAIN. I think, Mr. Chairman, your invitation for these hearings certainly is galvanizing us into taking a specific look at the issues here.

We have somebody in my office that regularly follows technology-related issues, but in the context of preparing for this hearing, we discussed the various proposals, both with Mr. Rule's office, as well as with officials of the Commerce Department, and I think that given the fact that it is clear, at least from the statements made here, that the interest of these subcommittees is to try to put a move on this legislation as opposed to letting it sit around and see what happens, we could initiate contacts with various small business organizations which I mentioned earlier for reasons that they have priorities elsewhere, they may not have focused on this.

As I said, their principal reaction will be, "Give us the simplest procedure." I think it is important to explain the tradeoffs which Mr. Rule articulated, that there is a certain tradeoff, against cer-

tainty of exemption, and speed, and simplicity, and low cost of the certification process.

You have some other witnesses here from the small business sector this morning that may have specific opinions.

We will attempt to contact several organizations which may have an interest and report back to you.

Chairman ECKART. That would be extremely helpful.

Mr. Brumley, in your tenure at the Commerce Department, please identify for us what programs you believe worked best to foster competitiveness and new growth in our manufacturing or development processes.

Mr. BRUMLEY. First of all, exchange of information, the ability for domestic companies to talk freely among themselves. The role that the Commerce Department has pursued in that area is really a recognition that American business and worldwide business is so integrated now with information systems that a good idea, say a Steven Jobs idea in California, has a short shelf life.

Unfortunately, the idea moving to produce development and actually out on the street, if you will, is very dependent on who the strategic partner is.

If he has a strategic partner because of capital requirements who is not a domestic partner, then you have the internationalization of the idea very quickly.

Commerce has been worrying over that and watching it and efforts to find out how these ideas move so quickly onto the shelf and are so quickly pirated.

We have reported that there is a fear among domestic manufacturers or idea people that there is a perceived problem with the antitrust laws.

Rick and I have talked about this before, and I agree with Rick that the law is such that I doubt if a production venture pursued today in the domestic market would have a problem in a legal challenge.

But, unfortunately, with an innovator, a small businessman, an entrepreneur, or even a large company, antitrust exposure is a factor.

It is not that they believe they may be sued, they are certain they will be sued by a competitor, and settlement of the case will be access to the technology that they spent their energies money developing as opposed to actual damages.

I am off my area of jurisdiction, but I think if you look at our Federal acquisition regulations, we have heard in the business community and Department of Defense procurement offices where someone will have an interesting idea and bring it in as an unsolicited proposal to the Department of Defense. If it makes good sense, the Department of Defense says we must take your idea and put it with two or three other people to see if we can get a competitive bid for the Department.

The Department sought creation of this Technology Administration due to the short shelf life that sharing the idea creates. Number two, the Department promoted passage of the Federal Technology Transfer Act of 1986, which takes the fruits of U.S. federally funded research and plows it back into the private sector. Also, the Department pushed Executive Order 12591, which encour-

ages Government procurement as a way of keeping intellectual property rights in the hands of the contractor under a Government contract.

The problem is not the Sherman Act or the Clayton Act that poses a specific concern; it is the perception. It is the perception in products development or trade that participants in an industry raise antitrust as a problem. There are a number of cases where we have had meetings with industry officials in the Secretary's office and two or three CEO's who are competitors bring three or four antitrust attorneys to make sure that there is not anything said that one competitor might be fairly accused by a third of having colluded or obtained a competitive advantage.

It is a question of perception. So, for purposes of clarity alone, these hearings are important.

The final point is I notice you didn't ask me, if I sat up there, how I would write this exemption.

Chairman ECKART. I yield back the balance of time, Mr. Chairman.

Mr. BRUMLEY. Being a business lawyer, I think you have to have an exemption of some kind. I think you have to have an understandable process. I think you have to have a standard of proof and remedies.

If you go through your bill in those four component parts, both bills have exemptions. It is just the process and the remedies which differ.

On standard of proof, you both agree, rule of reason is expressly placed in H.R. 423 and Boucher-Campbell as a standard by which the court should be identified.

Your remedies, I think, should be in balance with the exemption you choose.

If you choose notification, you keep the damages in there in case the activity evolves into something beyond what was represented.

In the certification process no damages are required because you can block before it goes forward.

So, from the standpoint of weaving the two together, I don't think you have much weaving to do. I believe the real question before the Congress and the administration is, do you fully disclose your transaction to the Antitrust Division early or do you disclose later?

Chairman ECKART. Thank you.

Chairman WYDEN. Thank you very much. The gentleman from Massachusetts.

Mr. NEAL. Thank you, Mr. Chairman. The question I have for Mr. Swain or Mr. Brumley will be simple. Could you cite some of the European success specifically? Give us a model that has worked well in Europe.

Mr. SWAIN. I can cite the article, which I haven't yet read myself, in our testimony that described particular experiences in Sweden.

I have in my own experience read articles that talk about the flexible manufacturing advances in Japan, and I would certainly be happy to supply you those.

I am not enough of an expert myself to describe them now.

Mr. NEAL. Are there particular industries that have benefited, in your estimation?

Mr. SWAIN. I suspect a later witness will have experience on machine tooling. There has been much on how it affects machine tooling in particular.

Mr. BRUMLEY. I would offer an example, an organization in Europe not well known in the United States. It is a consortium of about 100 to 150 different kinds of companies, service industry, banking companies, and manufacturers—IntoSpace. Its responsibility is to take technology that comes out of the European space program and spin that technology into nonspace products and services.

It is a very, very successful consortium that deals with both high- and low-technology partnerships among consortium members. It has a model in the European space agency, and it is probably one of the best examples of a large organization with minimal Government involvement.

In Japan it is not so much the success stories as how the success stories were able to become success stories.

I think that is because of MITI. MITI's has the ability to reach into industry to promote emerging or declining technologies and encourage industry with a kind of antitrust exemption by bringing them in under the umbrella of the Government to direct investment in new lines of products or technologies.

Once the investments have been made and the winners and losers in the industry identified, they send them out to compete against each other and to compete worldwide.

It is that ability to bring them in and give them that kind of direction with which MITI has been very effective. We don't do that in the United States. But we have a new Technology Administration and hopefully a strong science adviser who can get the information out there so business can decide on its own who it should cooperate with.

Mr. NEAL. Thank you.

Chairman WYDEN. The gentleman from California.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Mr. Swain, I will state an observation and ask you to agree or disagree with it. It is my observation that as long as some damage actions are available to challenge a joint venture, including the attendant cost to a company, particularly a small business, of litigation, and the attorneys fees, that there will be some small business that will take the choice not to go into a joint venture.

In other words, that the detrebling relief of H.R. 423 may not be enough for small businesses concerned about loss of time, single damages, and attorneys fees.

That is my observation. You are in a much better position to judge.

Mr. SWAIN. I wouldn't disagree with your observation, Congressman. I might make a sort of an observation, though.

To the extent that either of these investigations or any other investigation raises the ante on disclosure to the public which is oftentimes tantamount in what you disclose to the Government of one's processes, one's expected markets, and any other details involving either current or projected production, then I think that

smaller businesses in particular are going to be wary for reasons that have nothing to do with antitrust.

We have done some studies in the past that indicate that many smaller firms and new technologies did not use the patent system as much as larger companies because they are concerned about disclosure of their processes to their competitors.

So, I think that antitrust concerns are one which this committee has focused on, but I think intellectual property concerns represent a tradeoff there and, perhaps, further discussion of that aspect of the issue would be informative as well.

Mr. CAMPBELL. A general rule, as I view the problem, is not to allow market power from a consortium sufficiently large in any market so as to dominate it.

Market power is defined as the ability to exclude competition. In this context, I wonder why there is a need for a number of employees' tests.

That is to say whether the remedy, whether it is under H.R. 423 or H.R. 1024, out to be defined in terms of the size of the firm's employment base or whether it is not simply appropriate to ask a market-share question.

Mr. RULE. I tend to agree with you, Congressman. I must admit, as I read H.R. 423, I thought it was very effective in pointing out through its definitions the fact that small business was an important constituent of the legislation, but, as I read through the legislation itself, I don't find, unless I am missing something, that its coverage is either limited to those who are defined as small busifesses or that the test under the substantive provisions or notification provisions, undess I have missed something, depends on classification as small business or not.

Mr. CAMPBELL. I appreciate that. It is the reference to the definition of small business in the bill which struck me as potentially extraneous to the antitrust concern.

You have read H.R. 1024 and the procedure that is established for the certification process. You have more than a little familiarity in enforcing the antitrust laws.

I want to ask you a pointed question. I bear in mind that you and I once took different positions on the question of whether an extended period of time was needed for Hart-Scott-Rodino. I said yes; we need more time. And you said no problem; we can handle it. Trying to rope you with your previous testimony, do you have any problem with applying the standards set forth in H.R. 1024 within the time period, namely the 60 days?

Mr. RULE. Not really, but I think that it is important to point out that the reason I say that is much the same as the reason I think that an extension of the Hart-Scott-Rodino time periods were necessary.

Assuming that you have a 60-day period, the fact is that what will happen in those cases is that you will see requests for additional information which will toll the period, and if there are issues that we need to look at further, I am sure that we will negotiate with the parties for some procedure that enables us to ensure that we get enough information to look at the particular joint venture.

So, I think that it would probably work. I think that what would happen is you would have much more than 60 days. I might also

note that part of the procedure in H.R. 1024 is interesting because it sets out what one might define as sort of Hart-Scott-Rodino rules in terms of the information that has to be disclosed initially.

It is an interesting concept because what it tries to do is require presentation of information based on economically defined relevant markets.

The problem with that is that, as you well know, the way in which I define a market would be very different from the way you define a market or anybody else, which I think will lead to, in many cases, a request for additional information, because we both know the problems with using Civil Service codes to provide information because they are not adequately defined markets, but, at least, they provide an objective standard that enables us to take the information and work with it.

Because it is within the power of the party filing to define the market as he pleases, the Government may find it necessary more often than they do under the Hart-Scott-Rodino to get additional information to make sure they understand what these parties are doing.

Mr. CAMPBELL. The bill does require a second request. One last question for Mr. Brumley. Mr. Brumley are you familiar with a study by Professors David Teece and Tom Jorde?

Mr. BRUMLEY. Yes, sir.

Mr. CAMPBELL. If you are, are you familiar particularly with their evaluation of whether the National Cooperative Research Act of 1984 is a success? Looking at the number of filings under the NCR 1984 as compared, for example, with the European instance——

Mr. BRUMLEY. The specific reference I don't recall. All I can tell you is I had a conversation with them after the piece in the Wall Street Journal.

It was my feeling from that conversation that they were looking for something separate and distinct from the NCRA approach. I guess I can draw from that they were not satisfied with the number of filings.

Mr. CAMPBELL. Perhaps I can submit into the record, Mr. Chairman, that portion of the Teece and Jorde report entitled, "Registrations Under the NCRA Are Disappointing But Not Surprisingly Low," making a point that of the 111 filings, the majority tended to deal with joint ventures of under $5 million per year, and cataloguing the types of filings, the vast predominance were in environmental health medical joint ventures that were necessitated by some other Federal statute, and comparing that with the EEC where the filings have been over 3,000 per year instead of 30 per year.

Chairman WYDEN. Without objection, so ordered.

[The information may be found in the appendix.]

Mr. CAMPBELL. I yield back with this comment for the Chair, and my colleague from Ohio, that this has been very fruitful, and I believe that we can work together. If the hypothetical were that I were here drafting this bill, it seems to me that a real potential exists for two slots, and you pay your money and take your choice.

Chairman WYDEN. I thank the gentleman and look forward to working with him.

Mr. Swain, could you have the SBA survey, the small business groups within the next 30 days and get an opinion? We have the National Tool Making and Machining Association here today. They have already endorsed H.R. 423, and I think these groups are now in a position to analyze this legislation.

So, you can get back to us within 30 days——

Mr. SWAIN. We will be happy to do that, Mr. Chairman.

Chairman WYDEN. A couple of other questions, if I might. Has the Department made any assessment of small business participation in the Export Trading Company Act?

Mr. SWAIN. The straight answer is no; I couldn't begin to give you a figure. Although I must say that I may not be aware of everything, it may be that our international trade office has some greater knowledge of that.

If I may, I want to take at least a positive implication of your questioning, and Mr. Campbell's questioning, and point out that to a degree, debates over the success of the ETC Act, whether you define success in terms of numbers of companies or organizations certified under those laws, I am not sure that is hitting the points. You may have successful laws, yet not enough companies as you might expect pursuing the avenues under those laws for market and economic reasons.

In other words, it is very tough to get involved in international trade regardless of the laws written in Washington. That is one of the frustrations that we have had. We want more small businesses to get involved in international trade.

The fact is that it is hard to figure out whether it is a legal problem or a business problem. Let me try to get information for you either from our files or from the Commerce Department on small business and international trading companies.

Chairman WYDEN. Do you think that most small businesses have the sources and the expertise to go through certification? One of the reasons that I looked at the notification route for small business is we want to make it quick, make it straightforward.

It will work in cooperative research. Do you think that most small businesses have the resources to go through the certification route?

Mr. SWAIN. Most small businesses, I think, would attempt to hire the expertise. Whether they have the resources is a judgment question. If they want to do it badly enough they will have the resources to do it, but it is going to be less expensive simply to notify than it is to certify.

Chairman WYDEN. One of the things that I liked about the Cooperative Research Act and going the way we did in H.R. 423 is we could use the money to push the joint venture, the joint manufacturing network rather than pay lawyers.

Since almost everybody up here is a lawyer, we can declare our conflicts right here. That was one of the attractions.

Mr. BRUMLEY. If I could continue on that——

Chairman ECKART. Are you going to defend lawyers now?

Chairman WYDEN. That will go over like defending the pay raise.

Mr. BRUMLEY. I was on vacation during the pay raise. I would say, Mr. Chairman, that you have under the certificate process something that you don't have under the notification process, and

that is, if there is a certificate process and there is a defined role for the Department of Commerce—the Undersecretary for Technology or whomever has the assigned lead from the Secretary of Commerce—you have a business advocate who is advocating within Government.

You can't buy that. You cannot buy a better advocate than a department interagency process.

Under the Export Trading Company Act, the Commerce Department and the Antitrust Division work out their problems. I would think that someone seeking to enter into a new area of technology will probably find their way to Commerce Department anyway for industry information or guidance.

If they have to go the notification procedure on their own, they are going to find counsel to prepare that for them, but then the Justice Department is in the position of not only being an enforcer, but also a promoter of the exemption. That won't work.

You split these responsibilities. The business organization becomes the promoter of the exemption and the enforcer remains the enforcer.

Of course, it would be the enforcer's final word that it would go forward.

Chairman WYDEN. Mr. Rule.

Mr. RULE. Mr. Chairman, I just wanted to make one point. You asked several questions about the export trading company procedure, and I have a little bit of information which indicates that there are, for example, 90 certificates and 18 amendments issued.

One thing that is interesting is the largest group of companies involved in any ETC is one sponsored by the National Tooling & Machine Association. Perhaps they can give you a good idea of the cost of an ETC certification process when they speak here later today.

Chairman WYDEN. Since they endorsed H.R. 423 it is going to be interesting. You all are very kind. Do any of my colleagues have any other questions they would like to ask?

The gentleman from California.

Mr. CAMPBELL. Just a followup on a point that the chairman made. Mr. Brumley, the burden of small business of filing under the certification procedure is in my view made substantially less by the so-called fast track option under H.R. 1024 which requires you merely to identify your joint venture and the market shares, period.

Then you have your exemption. It seems to me that if you are small, you are likely to fit under the fast track since that is defined in market-share terms.

Is my understanding of that correct, and can you comment on that responsive to the chairman's concern?

Mr. BRUMLEY. I believe you are correct. You have a cutoff so to speak which is, I believe, a relevant market test cutoff.

Underneath that there is very little process and above that is a more protracted certificate process. When you are assessing or quantifying, it is not so much how many tracks you have to go through; it is how many people you have to deal with and how long is it going to take.

Underneath that market-share test—although the jurisdiction of this committee is small business, there shouldn't be anything in the legislation that restricts access to the process of the exemption or what you are doing here today to small business per se, because they may have strategic partners which are large business, and if you are using a market-share test, the way things are going in our market right now, almost every one is small business in terms of market share if you factor in international market trade.

Chairman WYDEN. Gentlemen, thank you. Our next witness is William C. Norris, chairman emeritus, Control Data Corp., Washington, DC. Welcome. You are standing and you have no objection to being sworn.

[Witness sworn.]

Chairman WYDEN. Mr. Norris, it is always a pleasure to be able to work with you. We know of your longstanding innovative approaches to economic development. We will make your testimony part of the record, and if you could summarize your principal views here, that would be very helpful.

TESTIMONY OF WILLIAM C. NORRIS, FOUNDER AND CHAIRMAN EMERITUS, CONTROL DATA CORP., CHAIRMAN OF THE BOARD, THE WILLIAM C. NORRIS INSTITUTE

Mr. NORRIS. Thank you very much, Chairman Wyden, Chairman Eckart, and other members of the subcommittee.

Having long been an advocate of expanded cooperation in our society, I was very, very pleased to see this initiative to amend antitrust.

I will provide some excerpts from my prepared statement. However, before commenting specifically on H.R. 423, I should just tell you a little bit about my current activities to advance cooperation in manufacturing carried on under the aegis of the William C. Norris Institute, of which I am chairman.

The mission of the institute is to catalyze public and private cooperation to address the unmet or poorly met societal needs. The only way these are going to be adequately met is through cooperation to more efficiently utilize our scarce resources.

Our institute program is called the Advanced Integrated Manufacturing Services Center Partnership. I am sure you know the impetus for the program—simply that U.S. industry is not getting advance manufacturing technology in use soon enough by either most large or small companies.

Again, there are numerous reasons. Just to mention one, the point has been made today there is substantial investment required. It is unaffordable along with unacceptably high risk due to uncertainty of demand for products of the manufacturer.

Additionally, a small firm will not usually be able to justify the increase in capacity coming from the investment in automated facilities.

There are a number of ways for helping to overcome these barriers: Consulting assistance, education and training, shared ownership of manufacturing centers, flexible manufacturing networks, which is the subject of this hearing, and manufacturing service centers.

Further, in determining the most effective ways to help smaller companies utilize advance manufacturing technology, it must be kept in mind that there are three types of companies to be served, the parts manufacturer, which is a job shop, and then there is the product manufacturer, and very important and sometimes overlooked, the startup manufacturing company.

In considering the spectrum of these companies with varying technology needs, it is clear that manufacturing service centers merit the major emphasis because they offer answers to the problems of high initial cost, risk, and capacity utilization that is faced by small- or medium-sized companies.

In fact, the availability of manufacturing services will facilitate the formation of shared ownership and flexible manufacturing networks because the cost and risk can be assessed before a commitment to the required investment is made.

The essence of the program for the implementation of the services approach is the establishment of a nationwide network of various types of advanced integrated manufacturing service centers.

They would perform design and manufacturing on a service basis with a company paying for services as they are used with no investment required in the center facilities.

Each company utilizes the center through a work station on its own premises connected by a telephone channel. Progress is being made in establishing AIM centers.

Currently, the AIM centers partnership has a relationship with three advanced manufacturing center networks in the development stage.

One is the Advanced Manufacturing Network. The members are community organizations in Pennsylvania, California, Minnesota, and Mississippi.

Then there is the North Industrial Regional Manufacturing Services Center partnership. Members are community organizations in six States, and there is the Minnesota Advanced Manufacturing Technology Centers, and its members will be community organizations in six to eight regions of the State.

Also relevant to the hearing today is a study by the AIMS partnership, possibly in cooperation with the Northwest Area Foundation, to identify potential flexible manufacturing Networks within the State of Minnesota.

It appears that a number of sectors could benefit from that approach. Die casting, plastic injection molding, composite materials and products, medical instruments, wood products, and food processing.

The problems attendant to establishing a shared manufacturing network, of course, can vary greatly depending upon what is being manufactured.

Ordinarily a facility for producing parts will cost much more than for one producing products.

Even a shared facility for manufacturing parts will be difficult for many groups and small companies to finance.

In addition to the cost barriers, there is the fear of antitrust which we are talking about today.

I will now comment on H.R. 423. I am pleased to see that the proposed legislation follows the pattern of the National Cooperative

Research Act, because that approach has been very successful in my view, and from other comments this morning. However, I am concerned that the proposed legislation departs significantly from the Cooperative Research Act in two respects: The bill would apply only to companies with 500 employees or less and to groups of companies having less than a 20-percent market share in the relevant market.

While I understand the concern by many about making exemptions from antitrust laws, of course, neither the Cooperative Research Act nor H.R. 423 exempt anything. Treble damages are reduced to single damages, and the rule of reason, as we know, applies rather than the per se rule.

Thus, the penalties would still be severe enough to deter undesirable anticompetitive activities.

However, by requiring a 20-percent market-share restriction, ambiguities are created. Defining a relevant market, what product and what geography, is a very wishy-washy process. It can be global or a single metropolitan area covering very narrowly or broadly defined products. It can depend upon who is paying the economist.

Consequently, there is not going to be the certainty that a small business has to have, and also the cost of a legal opinion will be burdensome.

With respect to the 500-employee limit, it appears to me that company size is irrelevant from an antitrust point of view.

At the same time, it may create a situation which precludes the right combination of people and resources being brought to bear for success in a selected area.

As we know, key elements to successfully bring a product to market are uniqueness in design and efficiency in manufacturing it.

The underlying genius for these functions is usually found in a handful of people, not a large number. If that nucleus were in a 600-person company, it wouldn't be eligible for a cooperative effort with other companies.

Earlier, I mentioned a study by the AIMS Center partnerships in Minnesota to identify shared flexible manufacturing networks.

One of the first being analyzed is a potential network of seven companies in a community with a population of 35 people. Although the study hasn't been completed, interest has been expressed by all of the companies in cooperation.

Two of the companies have over a thousand employees. One of the larger companies has the most important technology for a successful cooperative effort.

The other companies are much smaller. There is a need for cooperation because growth has leveled off for several of them.

However, H.R. 423, as now structured, would preclude the formation of the most effective cooperative effort. Nor is it likely that the smaller companies by themselves can finance the establishment of the shared manufacturing facilities even if there is an adequate amount of expertise among them.

Furthermore, it is not likely that many other similar groups of companies can marshal the financing to set up a shared manufac-

turing facility nor prudently assume the risk of utilizing its substantially increased capacity.

Or conversely, in many areas I believe that the number of shared ownership networks that we establish will be much greater if there is no limitation on company size under H.R. 423.

There is also some risk in virtually any major action in our complex society. In a fiercely competitive economy in which the United States is losing market share in industry after industry, antitrust isn't a significantly relevant factor in helping to stem the erosion. Thus, a prudent decision it seems to me, would be to make whatever adjustments to the antitrust laws may be necessary in order for industry to best respond to the challenge of foreign competition.

Finally, let me conclude by again applauding your efforts. Not only is it important to amend the antitrust laws to remove unnecessary barriers to cooperation, but such action will help create a greater awareness by business and other sectors of the urgent need to accelerate the adoption of advanced manufacturing technology.

Thank you.

[Mr. Norris' statement may be found in the appendix.]

Chairman WYDEN. Thank you very much, Mr. Norris. It is a pleasure to have you. You have been a champion of initiatives of increased competitiveness and particularly to keep the small business person and the small entrepreneur out there in the marketplace.

My question to you is, given your counsel, and thoughtful counsel is always that we do something about the size limitation, are there any concerns you have that if we just take the size restrictions off altogether, that we could be knocking that small entrepreneur out of the box? Are there any kinds of steps that we ought to be taking as we consider this legal labyrinth to make sure that the small guy is going to be out there and going to be a competitor?

Mr. NORRIS. The point was made earlier about the great creativity of small business, and I believe in that, and I am here to preserve and enhance it.

But small companies today are strapped for money, and it is going to be very, very difficult for them to respond here in cooperative efforts, even though they want to, because of lack of money.

Many times if you can get them connected with larger companies, then the larger company can help alleviate that extreme financial bind.

I think it works absolutely the other way. I have no feelings at all that removing size limitations will do anything other than help the situation.

Chairman WYDEN. You also testified you were concerned about limiting the market share of those participating in a given network to 20 percent. Do you oppose any restriction, or do you favor a tighter definition of market share, or how would you handle that?

Mr. NORRIS. I wouldn't even make it a requirement to try to figure it out, because it is very difficult to do. It depends on who is defining it. At one time somebody wanted to define IBM maintenance as a market.

In the computer industry, for example, what is a computer? You can talk about power, you can talk about application, but the same

computer is used in many applications. A small computer can be connected with several others and become a large computer.

So, it is as I said, a wishy-washy process, and I don't believe market share today is something that we need to worry about other than to get more of it, because the competition, foreign competition is really hurting our country.

Chairman WYDEN. There is no question that a political slogan that consists of more is a winner. We appreciate that.

The gentleman from Ohio.

Chairman ECKART. No questions.

Chairman WYDEN. The gentleman from Massachusetts.

Mr. NEAL. I come from a part of Massachusetts that has experienced a lot of turmoil in the hand tool industry. It is interesting that over the course of the last few years where the big manufacturers have had all kinds of problems, the small job shops have done extraordinarily well by American standards.

Would you care to give a casual observation as to why that might have occurred?

Mr. NORRIS. I suspect that the smaller ones were more flexible to the changing situation, faster. Large organizations are hard to turn around real fast. I know from experience. That of course is the advantage of small, but at the same time, both resources that a large company has are extremely important. So, if we can couple them together, then America will have put its best foot forward.

Chairman WYDEN. The gentleman from California.

Mr. CAMPBELL. Thank you, Mr. Chairman. Mr. Norris, I appreciate your testimony. I have one question for you. In the event Control Data or companies like that were to form a joint venture in manufacturing—not just R&D but down to manufacturing—including major sunk capital costs, I am concerned that having sunk that amount of cost, they may subsequently be at risk to an order of a court, "Sorry, your having sunk the costs; too bad, but there is an antitrust violation." I am concerned that because of that fear they, perhaps, may not sink the costs in the first place.

In other words, when we move from research and development into heavy capital of manufacturing that there may be a chilling effect unless one is assured going in that there won't be the prospect that one will be told stop after one has begun. Now that is a supposition on my part. I am interested in your observation as to whether it is accurate or not.

Mr. NORRIS. Absolutely. I don't think Control Data today would seriously consider going into a production joint venture of the type we are talking about without some change in the antitrust law, because they would be very vulnerable to at least civil suits if not Federal.

Mr. CAMPBELL. With the chairman's permission, I would like to pursue it one second longer. It is not merely that some antitrust suit might happen or some remedy is awarded. I am focusing on whether the proposed remedy of detrebling is enough, if you must sink costs. Say you are going into heavy manufacturing, you have capital costs; I am concerned it may not be enough to tell you, well, you can still be stopped, but you will only have to pay single damages.

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Mr. NORRIS. If you sunk the cost and are told you can't do what you sunk it for, that would be a deterrent. If you will remove the company site limitations and remove the market-share limitations, I think that Control Data, of course I am no longer the chief executive officer, but I think any large company would consider that a reasonable environment.

Mr. CAMPBELL. Thank you.

Chairman WYDEN. Mr. Norris, we thank you very much. We certainly will be in touch with you as we pursue this important issue.

Chairman WYDEN. Our next panel, Matthew B. Coffey, president, National Tooling & Machining Association, Joe Sims, attorney, Jones, Day, Reavis & Pogue, member, Antitrust Committee, American Bar Association, Robert E. Friedman, president, the Corporation for Enterprise Development.

We thank you and appreciate your patience. At least two of you have been before this subcommittee before and are aware of our procedures and rules. Do any of you have any objection to being sworn.

[Witnesses sworn.]

Chairman WYDEN. We will make your prepared remarks part of our report. Why don't we begin with you, Mr. Coffey. You have been particularly helpful in trying to fashion this legislation. We thank you for that help and look forward to your testimony.

TESTIMONY OF MATTHEW B. COFFEY, PRESIDENT, NATIONAL TOOLING & MACHINING ASSOCIATION [NTMA]

Mr. COFFEY. Thank you Mr. Chairman. I think rather than referring to my testimony at all, I will just go to the issues and points that I think you have raised with previous witnesses and try to address them directly.

As you realize, my organization represents 3,100 small businesses, average employment 21 employees, so they truly are at the small end of the manufacturing spectrum. We have been very aggressive in pursuing all opportunities to make them more competitive, and what we now see as a global market, we tend no longer to think about the U.S. market because it is too small.

There are too many competitors in the world, and we have to approach the world from that perspective.

One of the issues that has been raised here is why the 500 limitation? I think it is clearly a product of experience. In the Italian mode, in the Danish model, all of the models we have seen in Europe, they are all small company consortiums.

Why is that?

Because small businesses and large businesses do not normally get along very well, particularly when it comes to cooperative arrangements. The large business tends to dominate the arrangement and, over time, tends to take it over from the small business.

What we are attempting to put together here is a true consortium approach which encourages individual entrepreneurs who at this point in time are afraid to cooperate with each other to get into a mode where they will be able to form consortiums, not in the sense of a formal joint venture, not in the sense of getting a bunch of lawyers together to write an agreement among the companies to

come to some sort of a deal, but an arrangement whereby small companies can flexibly connect with each other to accomplish a market objective and can flexibly unconnect from each other just as quickly as they connect. So, we are not looking at something that is going to be chiseled into stone and require a great deal of legal definition prior to its creation or prior to its dissolution.

What we are after is flexibility, because flexibility is what is going to be able to make us and keep us competitive in the world market.

We have had some experience with governmental processes. We do run the largest single export trading company in the United States as an association. That export trading company has 3,100 members in it, and we add and delete members regularly from that process. The problem with that process from my perspective was the fact that without the association forming that trading company, my people would have never had a trading company, because the up-front legal costs of the certification process were prohibitive.

Gentlemen of the antitrust bar are now collecting $250 an hour as a minimum fee, and when you use them to file an application, which normally in the case of our application runs about 100 pages, which requires a whole series of tests to be performed on market share and other matters, we wound up spending in legal fees alone, for an export trading company, in excess of $30,000.

Now, I don't know of any 20-man shop in the United States or any five 20-man shops in the United States that are going to want to spend that type of money for the absolute certainty they are going to get off scot free if their venture happens to work.

Again, we are talking about small business, we are not talking about businesses where you have legal staffs. We are talking about businesses where the person who owns it normally has the spouse doing the bookkeeping, has 8, 10, 12, 15, 16, up to 40 workers in the plant, and they are pretty much running it by themselves, and those of you who have been to job shops around the United States know exactly what I am talking about. We are not talking about people used to dealing with Government directly, and, therefore, they form an association to try to do that for them, but they are not likely to come together in flexible networks if that flexibility is constrained by a precertification process of the United States.

It is hard to get them to not even use basic Federal information because the volume is so large they can't digest it. The process doesn't work if you get a certification process.

Now, the best of all worlds is to have a postcard application with absolutely total immunity, and I would be happy to advocate that if any of you thought that would be accomplishable through the Judiciary Committee, but I don't really think that it is going to work. So, I think what we are trying to strive for here is some middle ground that the Judiciary Committee is going to be willing to accept that doesn't impose an artificially high economic burden on the front end of the small business wanting to get into this venture.

While I, as an association, can in the export trading company account put all my companies into the export trading company, joint ventures are not envisioned to include all my members. They are envisioned to include four or five of them getting together to do a

project, to bring a new product to market, to do something quickly to respond to some foreign competitive encroachment, to be able to flexibly work in the domestic market, and, while as an industry, we are going to work with whatever system you come up with, our preference up front would be the simplest possible front end system with the best protection we think it is reasonable to expect out of the committees of Congress with jurisdiction under the antitrust laws. I think that is what we have tried to accomplish in H.R. 423.

The thing I see happening which I think is very encouraging is that since last year we have seen a tremendous increase in interest in this business. Last year we brought to you the project in Meadville, PA, as the single example. Two weeks ago, I was contacted to host a meeting to form an association of flexible manufacturing centers in the United States of which there are now 10. So, the market is already forcing this thinking to happen, and what I am hopeful is that we can move to get the legislation in place so that the process doesn't get slowed down. It is out there happening right now, and I think that is a very important thing to note.

I also note this morning's Wall Street Journal gave us a piece on cooperative ventures by small firms which says to me that we are not only getting attention from the Congress, but we are getting attention across the business community. I know the big businesses would like to get in on this, because it is a neat concept, but from our perspective the concept works in small business. It has been proven to work in small business over a period of time, and what we are proposing you do is go forward with this kind of a concept from the committees.

Thank you, Mr. Chairman.

[Mr. Coffey's statement may be found in the appendix.]

Chairman WYDEN. Mr. Coffey, thank you. Mr. Sims.

TESTIMONY OF JOE SIMS, ATTORNEY, JONES, DAY, REAVIS & POGUE

Mr. SIMS. Thank you Mr. Chairman. I appreciate the opportunity to appear here today before this joint hearing. I particularly appreciate the opportunity to appear before one of my former colleagues who has now found a respectable occupation.

This is obviously an important issue. It is almost certainly an issue of perception and uncertainty rather than of the actual legal standards applied, because in today's environment manufacturing efforts that would qualify for relief under H.R. 423 would surely in the end not be subject to successful antitrust challenge. Still, there would be no way to guarantee they couldn't be challenged and that people would not have to spend some money. So, there is an issue out there that is a legitimate issue. It is also a more complex issue than it might appear at first blush.

It would obviously not be anybody's goal, including the members of these subcommittees, to open the door to anticompetitive conduct that would merely injure consumers and not advance the goals of this legislation. You wouldn't want to create a mechanism which could be used simply to injure consumers as opposed to advancing their interests. Thus, the key, in my view, is finding a legislative formulation that provides the necessary kind of comfort to

encourage people to go ahead with these activities without providing an umbrella for anticompetitive behavior.

H.R. 423 certainly contains significant elements of a process that would satisfy that recipe. You are going to have to have some form of notification in order to bring these activities to the attention of the enforcement agencies, so that in those rare instances when there are anticompetitive problems they can deal with them. You are going to have to have some kind of assurance that people are going to not be subject to any kind of per se attacks; that protection is critical.

You are probably also going to need a provision, as in the NCRA, that would limit damage attacks and the potential for attorneys fees. I might note, to show the relevance of this, that there was a recent antitrust case of some notoriety involving the National Football League and the U.S. Football League where, at the end of the day, the plaintiff won a verdict of $1.00 in damages and was awarded a little bit over $5 million in attorneys fees.

So, attorneys fees is a legitimate issue this committee should take care of. It also must be concerned about making sure that there are sufficient enforcement resources, both public and private, to guarantee these kinds of transactions do get reviewed on the merits. That review is the heart of the issue this committee and others in the Congress will have to deal with. Do you want the guaranteed review of a certification process with the costs, both private and public, that entails, and the certainty of the antitrust result? Alternatively, are you willing to take more risk; to accept the fact there may be an opportunity for anticompetitive behavior, but accept that risk in return for the advantage that you see to a more speedy, efficient, less costly process.

This is really the choice. The certification process would be a more complicated and more expensive process. If you can accomplish the goal without it, it would be highly desirable to do so. The real question, and the question that I am certainly not the person to answer, is can you accomplish your goal without the certainty that the certification process provides? Thus, there obviously is a good concept here that probably should and could move forward. I appreciate the opportunity to be helpful to the committee and will be as helpful as I can throughout the process. I would be glad to answer any questions that you might have.

[Mr. Sim 's statement may be found in the appendix.]

Chairman WYDEN. Thank you, Mr. Sims. You already have been helpful. We are going to take you up on your offer for more.

Mr. Friedman, it is a pleasure to have you as a frequent visitor to our committee, and we look forward to your testimony as usual.

TESTIMONY OF ROBERT E. FRIEDMAN, PRESIDENT, CORPORATION FOR ENTERPRISE DEVELOPMENT

Mr. FRIEDMAN. Thank you, very much.

I applaud your holding these hearings and for embracing the larger and more fundamental query which they represent. I am very appreciative you invited me back despite those former appearances.

Last fall, several of us testified and described the flexible manufacturing enterprise networks that had arisen in Europe and the promise we thought they held for the United States. I am not going to repeat in my testimony any of those descriptions, although I would be happy to try to answer questions about what I think we have learned from watching those efforts.

I will focus on H.R. 423, which I think is a remarkably responsive piece of legislation—responsive to both our hopes and to our concerns. It was patterned very clearly after the National Cooperative Research Act of 1984. As good as that legislation was, I think there are some fundamental differences between an R&D joint venture and a flexible enterprise network, and I would like to describe those before making some recommendations of other ways I think you might expand the current legislation—which I hope are also relevant to the consideration of H.R. 1024.

The first point I would like to make is that the issue here really is the changing nature of today's economy and how you accomplish the original aims of antitrust legislation within that new context. Now, obviously, not only the National Cooperative Research Act but a number of other administrative and legislative proceedings tend to deal with the changing economy. But I think we have to face up to the full dimensions of the change.

Basically, I don't think you can anymore, any longer, consider market share without referring to a global economy. Simple measures of national market share are inadequate, and the real competitive challenges we face are global. The way we increase competition in that environment is to enhance the potential of our own firms to compete at global standards.

Second, I think we have to recognize the incredible role new and young firms are playing in the American economy. Just last week Business Week had an article on, "Will We Ever Close the Trade Gap?" It noted the unexpected contributions of medium-sized and smaller firms to recent gains. Half of the new jobs in this country over the last decade have been created by independent firms under 5 years of age. I would argue that our best defense against market concentration is now a good offense, making sure that firms have easy entrance to the marketplace and have the capability, through cooperation, if not individually, to rapidly rise to global market standards.

The third difference is that whereas the National Cooperative Research Act was focused on defined joint ventures of larger firms or maybe medium-sized firms, the flexible networks of Europe involved small businesses—even microbusinesses, single entrepreneurs and three- or four-person ventures—which cannot compete at the global frontier unless they collaborate with others.

Unlike joint ventures, where you are talking about a limited number of firms and a defined set of activities in the networks, what you have is really better understood as a course of dealing among hundreds or thousands of firms an institutionalized collaboration whereby the best practice quickly becomes general practice.

My fundamental worry about the United States is not about our best firms. I think there is an analogy here to the education problem. We have found that the top 5 or 10 percent of our high school or college graduates compare very well to their Japanese counter-

parts; the next 90 or 95 percent we have to worry about. I think the same is true in business, the top 5, 10 percent of businesses of all sizes are really competing at global standards. They understand we are dealing with the global marketplace. They understand the role of new technologies, new management techniques, new training. What we need to do is move up the practice of the other 90 percent who have been lulled into complacence by the size of our domestic market and the relative lack of competition from their domestic peers.

Fourth, one of the things I have discovered since last testifying here is the amount of incipient network behavior by firms who would never identify themselves as being in networks.

Finally, you should note that the flexible networks of Europe are not restricted to manufacturing. Indeed, it is really hard in the new economy often to define the difference between, or the precise line between manufacturing and service business. The best domestic example of flexible network we have in this country is the film industry; is that a manufacturing venture or service venture? Is IBM manufacturing or service? Cummins Engine studied the problem with diesel engines and found the basic problems with the engines they were producing were the drivers, so, they started a major inroad into driver's training.

With this backdrop in place, let me make six recommendations I hope you take in the context of an inquiry rather than as definitive specifications.

Recommendation one: Add a statement of findings and purpose. Actually, the statement of findings and purpose contained in H.R. 1024 is admirable and would serve. I think part of the importance of this act is symbolic. It is an invitation to firms to collaborate. Let's make that explicit and let that govern subsequent interpretations of whatever we recommend.

Recommendation two: Remove the limitation to manufacturing. There are reasons to be particularly concerned with manufacturing, and there is reason to expect the predominant benefit of this kind of legislation will accrue to manufacturing, but for the reasons I have given you, I think it is an artificial limitation.

Recommendation three: Expand the definition of flexible manufacturing included in sections 2A and 2B. I make some specific suggestions in my testimony. Let me just say that the enumeration of activities there is somewhat limited. We could expand those. We will need to expand those to really invite firms in. I think you can be much more specific about what you want to prevent, that is, price fixing, restraint of trade.

I would suggest that you add a requirement that any network be open to new membership as long as that new membership was willing to pay their pro rata share of the costs.

Recommendation four: This is the most important one. I think you should consider creating a safe harbor. How you exactly define that, I confess I don't know. What I suggest here is that for firms representing not more than 20 percent of the relevant mature international market share, there would simply be a blanket exemption. Collaboration between smaller firms, firms entering new markets, which is increasingly the case, should fall under the safe harbor.

The price, even the knowledge, to initiate a notification or a certification procedure is beyond what many of the firms who are now engaging in incipient network behavior will be able to achieve.

Recommendation five: Specify that the competitive benefits of networks will be considered first in applying the rule of reason. The language in the Cooperative Research Act could be used here. I want to specifically note we expect competitive benefits to accrue from these networks.

Finally, clarify that the failure to follow a notification or certification should in no way prejudice participants in network in an antitrust challenge. What I am afraid of here has been raised before, that we may in this legislation win the battle by losing the war. We create a process where a few very conscious, probably medium-sized, or larger firms, or ones guided by an especially astute trade association, like the one represented to my right, might be able to take part but that would, as other witnesses have suggested, create a cloud on the activities, the unconscious activities, the much broader activities, that in the long run may be more important here.

To me, our major purpose in this legislation is to create a new business culture, to really move the general practice of American business toward the best practice of the global economy.

Thank you very much.

[Mr. Friedman's statement may be found in the appendix.]

Chairman WYDEN. Thank you very much, Bob. That really is an excellent summary to a morning of testimony to try to, in effect, change the global culture, and I am going to begin with a couple questions and then yield to my colleagues.

Mr. Coffey, I think it would be helpful for our subcommittee to understand exactly what the challenge is that your companies are facing overseas and what the dollars and cents ramifications are, what sectors are facing the most problems, losing jobs?

Why don't we begin with that?

Mr. COFFEY. I think that the biggest problem you see is a problem which was referred to here earlier. Why are the big companies in trouble and the small companies not at this point in time? Part of that is that the largest competitive disadvantage of the U.S. manufacturing base is its cost in people to manufacturing. What has happened is that major U.S. corporations have taken a lot of their production offshore in order to lower their labor costs.

The second approach they have taken is to subcontract more and more of their manufacturing production to lower their labor costs. Subcontracting normally will be less expensive than maintaining all the overheads that you have to maintain if you maintain large employment.

So, to a certain extent, you have seen it would have conscious policies directed by large corporations in the United States to lower their labor costs by, one, putting production offshore, therefore, putting know how and technology offshore, and, two, getting out of manufacturing, basically shoving manufacturing down to smaller and smaller units of manufacturing.

Chairman WYDEN. Excuse me one second. It is not just the private sector that is going offshore. Aren't Federal agencies like the Department of Defense going offshore?

Mr. COFFEY. Sure.

Just to try to keep the focus on manufacturing, the result of those major corporations taking all of that productive capacity offshore and all that know how offshore is to create indigenous tooling industry around the world, and we now have 14 free market economies with extremely strong tooling industries, and we are seeing develop in less developed countries now extremely strong tooling industries.

Well, as that knowledge gets around and then the tools to accomplish the kinds of precision that we have been known for, for a very long time in this industry get around because everyone can buy the latest technology for the right price, a quarter of a million dollars will buy you a machine that will produce parts to a machine no matter whether it is on a floor or sitting in some fancy building in the States, and it will produce parts to those tolerances.

We have seen a tremendous diffusion of the basic knowledge that used to be captive within a very few countries in the world, in terms of the tooling specialty. The result of that has been—that we have seen in Italy, for instance, which has no antitrust law—the creation of flexible networks that are not just in the tooling business anymore, they are producing proprietary products for the marketplace.

They are out there competing with Phillips, A.G., and other large European competitors, and they are competing with small appliance manufacturers in the United States as a network all the way to the end product. So, the rules of the game have changed dramatically, and I think that is really what we are talking about when we talk about trying to look at the antitrust laws which all of a sudden, because the rules of the game changed, have become a drag on competition instead of a help, instead of aiding the consumer by creating multiple choice. It is giving the market to the Japanese in recorders, or it is giving it to them in high definition television, or it is giving to one particular country to dominate our market without us ever imposing antitrust laws on that competitor because they are outside of our reach.

So, we have got ourselves in a box, basically.

Chairman WYDEN. What is going to happen if the status quo continues, if we can't get good legislation passed, and the Europeans and the Japanese continue to blast ahead as aggressively as they are, and flexible manufacturing, plus we see large companies going offshore, what do you see for small business and your people?

Mr. COFFEY. Well, I think what we are seeing around the world is a fracturing of the market concept. Traditionally, we have always approached the market by saying there are mass markets out there that need to be served by mass companies, but, increasingly, we are seeing personalization of products. We are seeing products being more and more narrowly defined in people's lifestyles.

What you will see, I think, is just a continuation of what you have seen in VCR's. You will see targeting of specific products that will be taken completely out of productivity in the United States.

Now one, on a VCR you might say that is not a real serious technology problem if all are made in Japan, but I would submit to you in the Defense Department they considered it a problem when they

found out the main bearings for nuclear submarines could only be manufactured in Japan. If you start to see that kind of thing occur, and if you look at the bearing industry in the United States right now, they are getting out of aircraft bearings. They are being made overseas. You get to those points where you say all of a sudden we have a real strategic defense problem because we will not be able to mobilize in the event. Some leader becomes irrational, and I think we have had more than enough evidence of irrationality of people over the last week or so.

Things don't always go along the way they are in this point in time, and I think the United States has to look at its industrial base and try to preserve some of those fundamental industries that are the base upon which all manufacturing is built, and, certainly, our industry is right in the center of that.

Chairman WYDEN. So, we have a national security issue very obviously, and if something isn't done, a lot of your people aren't going to be here in 5 years; isn't that correct?

Mr. COFFEY. That is correct. The know how isn't going to be here.

Chairman WYDEN. Let me ask you another question about that export trading company area. We have had some debate on this throughout the morning. It is your view if your association was not, in effect, the administrative coordinator of it, that small businesses that belong to your association just could not make it through that certification process, and the costs, the resources, and the like.

Mr. COFFEY. It wouldn't even be willing to put up with the hassle to go through it. Again, we are talking about people who run businesses where they do not have staffs. We are talking about people where the employees are direct labor. They are not people who fill out papers and forms and are comfortable in that environment. So, you are looking at a situation where it would not have happened. Some of them still wonder why it did happen, but, at the present time, I will tell you it would not have happened if it had not been for our intervention.

Chairman WYDEN. It is your conclusion that for large entities, large associations, it is a lot easier and a lot more doable proposition then it is from small entities?

Mr. COFFEY. Sure. Large entities have the staff. They have the legal expertise to put up with all this, and, as you know, a small businessman's attitude toward the Federal Government regulation is rather well known.

Chairman WYDEN. I think I will have some more questions in a minute, but let me just move on. Again, I want to thank you and your association for all the help throughout the summer and into the fall as we have gone ahead with this.

Mr. Sims, you made the point, in terms of defining the entities involved here, that I think is a really critical one because unless we do this we are going to have problems having a streamlined kind of process, so you can save time, and save money, and you took on your profession, of course, in the process in advocating that, because what we want to do is put the money into expanding businesses and not into paying lawyers.

Does H.R. 423 meet your test in terms of a streamlined kind of process of that, so the participants proposed joint venturers can go forward quickly?

Mr. SIMS. I think there are some ambiguities in the legislation as it is now drafted that ought to be looked at, and most of these points have already been raised. The issue of what class of entities is going to be subject to the statute is a question. As the statute is now drafted, my reading of it is the same as Rick Rule's. There is a definition of small business, but the statute as now drafted applies to any business, no matter what size. So, you have to be clear as to what collection of companies you are trying to cover. I would think you would also want to be clear that, whatever standard of size applied, the size was the size of the organizations at the time they filed the filing. It would be unfortunate in the extreme if the statute was drafted in such a way that companies under 500 employees could qualify to file and then, because at some point during the process they became a 600-employee company, they lost the protection of the statute.

Those kinds of ambiguities need to be cleared up.

Another quite serious problem, and really very difficult problem to deal with, is this notion of a market-share test. Obviously, the goal is to try to allow organizations who are not likely to be able to exert any market power to have a quick and easy road through the bureaucratic process, and that is a very desirable goal.

On the other hand, trying to create a system which allows people to self-certify as to what market share they have in what relevant market obviously raises the potential that people will either be wrong on the merits or that they will misuse that self-certification process in some way that creates a problem.

I see that as a very difficult problem to solve and keep the process simple. If you have a certification process that provides time for the Government to look at this very thoroughly and to make its own determination of what the market is and what the market shares are, that problem tends to go away.

But for the certainty you get there, you give up some time and effort. That is a difficult problem to solve. The goal to let smaller organizations do things is highly desirable. We should be willing to take more risks with smaller organizations than we will with larger organizations.

Chairman WYDEN. Your comments are not full ones, and, clearly, this does involve some very delicate drafting kind of activities, and we will very much want your help as we go forward with this.

Mr. Friedman, your testimony, as always, was excellent. I just have a couple of questions. I find very attractive the idea of expanding to services. My guess is you probably have to do that in another bill, simply because I doubt if you make friends as much as you make enemies in something like this. But I am interested in your thoughts with respect to services.

Do you favor a particular model for addressing the question of small business services, or how would you go about pursuing that?

Mr. FRIEDMAN. I guess I don't understand why the issues are any different for service than for manufacturing. I understand reasons for being particularly concerned with manufacturing. But even there I confess to being somewhat troubled. Service industries are

generally misperceived to create only low-quality jobs and serve only domestic markets.

We know good studies that suggest just the opposite, and if the real issue is that we are trying to come to grips with the realities of today's economy, then we really need to admit that the old line between service and manufacturing doesn't really exist much anymore.

I respect your desire to limit the bill to manufacturing. I will simply suggest there might be some problems down the road of defining exactly what is manufacturing and what isn't. But I think the same legislative construct would work for both.

Chairman WYDEN. Well, staff tells me that there is some legal argument to indicate that we might even be able to fit services under the manufacturing concept. Another area where Mr. Campbell and I can agree, and dig in, and go to bat for competitive economy.

You also make a very important point I think about simplification and making this as easy as we possibly can. Do you think the application and disclosure mechanism that is in H.R. 423 is too much paper and too much red tape? Would you do something alternative to that perhaps?

Mr. FRIEDMAN. I fear that it is too restrictive, and that is why I suggested at least trying to define a safe harbor. Again, I am clearer on the objective here than I am on the means of achieving it. But it seems to me the objective is not just a discrete number, be that 100 or 200 joint ventures, but really changing the behavior, the understanding of the nature of competition of most businesses. Now, this piece of legislation will not do that alone, but I think it really can recognize that we really have entered into a very different kind of economy where the threat, the competitiveness threat comes from abroad, probably not domestically, and that we need a new way of battling that threat.

Chairman WYDEN. Mr. Coffey, from the standpoint of your people who give us a great perspective on this today because all of your peopie are small businesspeople, do you think your people would find it easier to go with the application disclosure kind of process that we have in H.R. 423 or would they find it easier to try to define a safe harbor?

Mr. COFFEY. The simplest procedure is going to be the least onerous to them. Anything that involves them trying to establish a relationship that requires legal advice, will normally slow them down considerably.

I think what you are defining in H.R. 423 is a way in which they can almost make their assertions. Those assertions can be reviewed by whatever authority was in the Federal Government, and they can proceed with some confidence that they are going to be at least not facing treble damages.

You would like to get rid of all risk, but my people live with risk as an every-day factor. So, they are not afraid of risk. They are afraid of the punitive kinds of restraints being placed on them, and I think H.R. 423 meets the criteria.

Chairman WYDEN. I think this is obviously one of the most—the important issue. My sense is that from the standpoint of getting

into the process we can't get any easier in application and disclosure.

Obviously, there are other important kinds of issues, and, possibly, we are going to want to work with you and follow up on all your suggestions.

I want to try to send a message to the small business community that we recognize that a new day has dawned, and we are not going to be running a lawyerese, if you will, employment act any more. That is my sense, that we just chew up incredible amounts of time, and resources, and productive energy on forms and paperwork while our competition laughs all the way to the bank.

We are going to be working with all of you. I want to recognize the gentleman from California.

Mr. CAMPBELL. Thank you, Mr. Chairman. Mr. Coffey, if the interpretation of the proposed statute by Mr. Sims and Mr. Rule is accurate so that the reference to small business is not a requirement, and thus, you can have firms involved in these joint ventures and these flexible manufacturing operations that are larger, would you see that as a less desirable aspect of the bill?

Mr. COFFEY. From my experience it would be, and it would be simply because of the fears that I expressed in my remarks, small business is normally in a supplier relationship to large business.

What you are talking about in this kind of a venture is a partnership relationship. If you go to a large business and you define partnership, it is do it our way. If you have a bunch of colleagues coming together to form a partnership, it is a very different kind of mechanism that gets created, and that is my only hesitation there.

Obviously, I have thought about it, because I have a few members who are larger than 500, and we have debated this internally within our own organizations, but our feeling was that what you are trying to accomplish here is to encourage small guys to work together to change a culture, to change an attitude, to change an approach, to change 50 years of training which said you can't work together, and that is the whole objective that we are trying to accomplish.

I think letting the larger corporations into that mix dilutes that message.

Mr. CAMPBELL. One followup. To the extent that the bill would permit, but not mandate, larger companies' involvement, I should think you would have the best of both worlds. The smaller can if they wish but don't have to let in the large.

If the large were permitted in, they would dominate—am I correct?

Mr. COFFEY. That's correct.

Mr. CAMPBELL. I have a question for you and Mr. Sims dealing with the attorneys fees provisions of the bill. I refer particularly to section 5 of H.R. 423 which amends the attorney fees rule that is usual to antitrust litigation, so that a prevailing plaintiff will receive attorneys fees, but a prevailing defendant will receive attorneys fees only if the plaintiff's action was frivolous, unreasonable, without foundation, or in bad faith.

I raise that question first with you, Mr. Coffey, from the point of view of some of your members who might form one of these organizations. They have a flexible manufacturing operation going; they

are sued by somebody else. It turns out they were totally blameless. It strikes me as asymmetric not to have their fees paid.

Mr. COFFEY. In our written statement, I did suggest that be amended to apply equally.

Mr. SIMS. If you are trying to discourage frivolous lawsuits, it would not be consistent with that goal to have this kind of procedure.

Mr. CAMPBELL. The plaintiffs would agree if there is a need for change that attorneys fees go to plaintiffs, not defendants?

Mr. COFFEY. Yes.

Mr. CAMPBELL. Mr. Friedman, do you agree?

Mr. FRIEDMAN. Yes.

Mr. CAMPBELL. Mr. Friedman, you made a point during your testimony about a proposed improvement that would require the right to enter such a joint venture, that other parties be allowed to enter, I take it, upon payment of fees, or dues, or appropriate allocation of cost.

I wonder whether that is necessary from the point of view that if there are sufficient numbers of firms out there with capacity to recreate the joint venture, there are a number of times when people like who they work together with for reasons that you and I could never put in writing, but it would be true. Why spoil it when you, "Let Mikey in?"

Are you sympathetic to that point of view?

Mr. FRIEDMAN. Yes; there is a distinction in my mind between a joint venture with a defined membership and defined sets of activities and a flexible network.

For instance, in the Carpi knitware area, 600 firms, large and small, join to fund a service center, part of whose purpose is to track global market. Individual firms can't possibly afford to do that individually, and, therefore, they all pay a fee to join the center.

Out of that, something we would recognize as a joint venture grows. Perhaps you would consider that as a joint venture, but it seems to me the size in terms of firms is not something we commonly deal with in this country.

It is a very proactive trade association that is deeply knowledgeable of the business environment, of the needs of its membership and helps them define common problems and opportunities.

What I am trying to wrestle with in my testimony and the reason I put that openness piece in there is I would like to be able to define a safe harbor. I think we all have the sense that there is a line here somewhere where beyond that line, the issues get difficult.

But on the other side, you are dealing with so many firms that are so small, at least initially, that you really don't need to be very concerned about an antitrust, and you need to be very concerned that they are not exploring collaborative activities.

So, I wanted to recognize the problem of freezing some folks out in these larger conglomerations, but I do very much recognize the concern you raise.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Chairman WYDEN. I want to thank all our panel members. My colleague from California, I think we have had a very, very good discussion and hearing this morning.

It is quite clear that what small business wants is essentially what most Americans want from Government; they want some degree of certainty so that they aren't going to face a set of rule changes as soon as a policy gets promulgated.

They want to be able to do it without going through some bureaucratic torture and having to have batteries of lawyers to get it done.

You have given us helpful testimony as to how to do this. Mr. Campbell and our colleagues will be working together on this and go after this very quickly because we think the stakes are great, and every day we are not promoting this effort we know that our competitors are.

You have been very helpful, and we will be digging in, hoping to come up with good legislation in this area. We will ask you for counsel.

Thank you for coming and for all the patience and help you have given us.

[Whereupon, at 1:00 p.m., the subcommittees were adjourned, subject to the call of the Chair.]

Department of Justice

STATEMENT

OF

CHARLES F. RULE
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON REGULATION AND BUSINESS OPPORTUNITIES
AND THE
SUBCOMMITTEE ON ANTITRUST
COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

CONCERNING

COOPERATIVE PRODUCTION VENTURES

ON

FEBRUARY 27, 1989

Chairman Wyden, Chairman Eckart, and Members of the Subcommittees:

I appreciate the opportunity to appear before you today to present the views of the Department of Justice on proposals to encourage and improve the competitiveness of U.S. firms in worldwide markets by clarifying or altering the application of the antitrust laws to cooperative production ventures. Cooperative production ventures can frequently increase rather than diminish competition; thus, the antitrust laws should not be a barrier to their formation. Recently, the Department has worked to ensure that its antitrust enforcement policy does not chill the formation of legitimate cooperative ventures. The most significant part of that effort has been the recent publication of the Antitrust Enforcement Guidelines for International Operations, which describe in detail and by way of example, the Department's analysis of cooperative ventures.

Despite the Department's efforts and the considerable improvement in the sensitivity that the courts have shown toward cooperative ventures, there is reason to believe that the threat of private antitrust challenge may be deterring the formation of legitimate--perhaps even essential--cooperative ventures. There is concern in some parts of the business community and the government that uncertainty as to the standard for review of such ventures under the antitrust

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laws coupled with the threat of treble damage liability in private suits can provide a substantial disincentive to such ventures, even when they promise substantially to increase production efficiency and promote competitiveness. While the Administration has not as yet determined whether, or in what form, legislation in this area is necessary or appropriate, the Department of Justice wholeheartedly endorses congressional consideration of this problem at this time.

Scientific and technical advances have been made with dazzling speed in recent years. U.S. firms and government laboratories have been in the forefront of the research and development leading to many of these advances. U.S. strength in research, however, has not always been matched in bringing the products made possible by that research to the market. Today's increased pace of innovation has made it more imperative than ever that U.S. firms be in a position to respond quickly with state-of-the-art production facilities if the U.S. economy is to benefit fully from these technological advances.

Cooperative production ventures may be one of the most effective ways for U.S. firms to improve their competitiveness. The costs of commercializing new technology may be too high for any one firm to bear. In addition, the

pace of innovation has resulted in short life-cycles for many products, increasing the risks of investing in short-lived production facilities and demanding extremely quick reaction time.

Perhaps even more importantly, the increasing "globalization" of markets, particularly those incorporating advanced technologies, dramatically reduces the risk that cooperative efforts among some competitors will result in higher prices to American consumers. For example, a venture among American firms to produce D-RAMs (dynamic-random access memory semiconductors) would not likely be able to exercise market power because of the overwhelming capacity of Japanese and European firms. The presence of foreign competition, then, not only provides the stimulus for cooperative ventures--if American companies do not at times cooperate, they may find themselves driven from the market by their more efficient foreign rivals; foreign competition also often can protect U.S. consumers from anticompetitive activities that production joint ventures might otherwise allow.

Antitrust Uncertainty As A Possible Deterrent To Cooperative Production Ventures

U.S. firms may be deterred from the use of cooperative solutions to their problems by perceived potential antitrust liability. These firms should have nothing to fear from

federal enforcement of the antitrust laws. As recently spelled out in the Department's Antitrust Guidelines for International Operations, we have developed a rational and sympathetic enforcement policy toward joint ventures of all types. Most significantly, those Guidelines do not automatically condemn joint production ventures. They require the recognition of foreign competition where it exists, and ensure that potential efficiencies will not be ignored. Regardless of the improvement represented by the Guidelines, however, our antitrust laws rely on private as well as public enforcement. The fear of a private action for treble damages (and attorneys' fees) can be an even more powerful deterrent to conduct than the fear of government action.

The cooperative effort involved in joint production ventures should not raise any presumptions of antitrust concern. The antitrust laws were enacted to protect U.S. consumers from the unilateral or concerted exercise of market power. Strong foreign challenges in many of today's markets--including particularly evolving markets employing new, sophisticated technologies--make it unlikely that cooperative production ventures among U.S. firms would give those firms the ability to exercise market power and harm competitors and consumers.

Indeed, cooperative production ventures often have the potential for substantial competitive and economic benefits that promote and enhance competition. The antitrust laws proscribe only concerted activities that unreasonably restrain trade. Over the years as those laws have been applied, some activities, such as price fixing and bid rigging, have been demonstrated virtually always to result in an unreasonable restraint and are properly considered unlawful per se. No procompetitive justifications may be presented in such cases. Other activities, including particularly joint ventures, often promote rather than restrain competition, and thus must not be analysed under a per se standard but rather under the "rule of reason" which requires consideration of the procompetitive benefits of any challenged activity.

Cooperative production ventures offer a number of potential procompetitive benefits: sharing the often substantial risks inherent in bringing new technology to the marketplace; realizing economies of scale where an efficient output for a production facility would be beyond the needs of any one firm; achieving efficiencies in the purchases of supplies or in transportation; garnering economies of scope where a joint facility may produce more efficiently a variety of products to meet the needs of different producers; utilizing synergies arising from complementary skills or assets of the parties;

and reducing transaction costs in transferring to the production process important research information belonging to the parties. In sum, cooperative production ventures can capture many of the efficiencies of a merger with the advantage of preserving the independence of the firms outside the production process.

These potential benefits should not be lost because of fear that the risk of antitrust liability is high. As the Attorney General recently stated, "The U.S. economy can ill afford the burden of such fear." Therefore, legislation may be needed to alleviate any chilling effect of the antitrust laws on the ability of U.S. firms to produce in most efficient manners, and become or remain effective competitors in evolving domestic and international markets. We support and commend the consideration being given throughout the public and private sectors to proposals to ameliorate antitrust uncertainty in this regard.

Possible Legislative Approaches

The Department does believe that legislation can be developed that improves the antitrust legal climate for cooperative production ventures but at the same time safeguards the interests of competition. Such legislation would remove any artificial barriers to procompetitive conduct, but take

adequate care to protect consumers from unreasonable restraints of trade. Two basic approaches to such legislation recently have been much discussed. One could provide greater antitrust certainty for potential venturors through a high level of government involvement; the other could greatly reduce the potential risk of an antitrust challenge with minimal government intervention. These approaches are not necessarily mutually exclusive, and could be complementary.

Under the first approach potential venturors would seek prior review and approval by the government of their cooperative production venture. Such a review, conducted by one or more government agencies, (the Departments of Justice and Commerce and the Federal Trade Commission have been most frequently mentioned) would focus on the likely competitive consequences of the venture using a sound, market power oriented rule of reason analysis. All relevant information, including of course the potential procompetitive benefits discussed above, would be examined. Upon a determination that a venture would not be likely to affect adversely competition in the relevant markets, it would be certified.

Certification would insulate the covered conduct from challenge under the antitrust laws. This approach could thus provide a great deal of certainty to joint venturors who might otherwise be inhibited by the potential for costly antitrust

litigation. The price of that certainty is a significant commitment of time and expense related to the review and certification process, and to monitoring a certified venture's competitive effects. Certification might also inhibit the flexibility of some cooperative ventures in adopting innovative structures in an attempt to enhance their efficiency, although care in designing and administering a certificate program might ameliorate this problem.

Consumers' interests would be protected in two ways under this approach. First, the careful competitive review by the government prior to certification should ensure that the proposed conduct was not anticompetitive. Second, the government would monitor the actual effect of the venture through periodic review of its activities to discover and to ameliorate any emerging threats to competition. Upon finding that the venture or the surrounding circumstances had changed so as to threaten a restraint of trade, the government could modify or revoke a certificate. Subsequent conduct that was no longer certificated would be subject to antitrust challenge.

This first approach is similar in many respects to that enacted to encourage export trade activities by U.S. firms as part of the Export Trading Company Act of 1982. Under the ETCA, applicants may receive a certification from the Secretary of Commerce (with the concurrence of the Attorney General) that

their proposed export trade conduct would not have any adverse competitive effects in the United States or injure any domestic export competitor. Conduct certified under the Export Trading Company Act is not subject to direct challenge under the antitrust laws. However, the Act does allow private parties to challenge export trading company conduct that does not comply with the statutory standards for certification and to obtain injunctive relief or actual damages. A number of firms have availed themselves of the provisions of the Act; there are currently approximately 90 export trade certificates outstanding. One of the Act's most valuable features for certificate holders is that it virtually eliminates uncertainty about possible private antitrust suits that threaten punitive treble damages. Moreover, I have been informed that the Department of Commerce believes that management of the ETC Act has worked smoothly, and that the Act appears quite successful in achieving its goal of encouraging beneficial cooperative exporting ventures that business otherwise would decline to pursue because of antitrust uncertainty.

The second approach would not completely immunize any activity from challenge under the antitrust laws, but would reduce the deterrent effect of such potential challenges by ensuring that the correct antitrust analysis is conducted and by providing an opportunity for cooperative production

venturors to limit any possible antitrust liability to actual damages. Under this approach courts would be required to analyze any challenged joint production venture under the "rule of reason" rather than the more restrictive per se rule. This would guarantee that the venture's procompetitive benefits are given full consideration.

Venturors seeking further protection could notify the government as to the identity of the parties to the venture and the nature and objectives of the venture. The outlines of the venture would become public, and disclosure would reduce the parties' potential antitrust liability to actual damages plus a reasonable attorney's fee.

Under this second approach, consumers would be protected because no immunity from the antitrust laws would be conveyed and both public and private enforcers would retain their ability to bring suit against a particular venture when they have adequate proof that the venture actually would have anticompetitive effects. Moreover, because of the public notification provision, an antitrust suit seeking injunctive relief could be brought at the earliest possible time, before any substantial competitive harm had occurred. Joint ventures could then proceed with their legitimate business activities free from the threat of subsequent private treble-damage

suits. In addition, the costs of this approach to both the government and the venturors would be minimal; virtually no government involvement or regulation in the structuring and supervision of the venture would be required. On the other hand, this second approach would not provide the same degree of certainty as a certification program.

This second approach was taken by Congress in 1984 in the National Cooperative Research Act (NCRA) to encourage innovation through joint research and development ventures. That Act could be extended with but limited revisions to cover joint production ventures as well.

The Department has been managing the implementation of the NCRA and we have found it to be quite successful. More than 125 notifications covering a wide range of research and development activities have been filed since the Act went into effect. We presume that an even larger number of ventures were sufficiently encouraged by clarification regarding the proper antitrust analysis of joint ventures under the rule of reason that they found the reduction of any possible damage liability through notification unnecessary. And as I mentioned earlier, these positive effects were accomplished without imposing regulatory burdens on private enterprise or the enforcement agencies.

To summarize, we have been told that U.S. competitiveness may be being inhibited by a perception that the antitrust risks of cooperative production ventures are too great. As I have discussed here today, most such ventures do not pose risks to competition and would not be held to violate the antitrust laws. To the extent that greater reassurance to U.S. firms is needed, a certification procedure or an extension of the NCRA could provide more certainty while fully protecting the interests of the public.

This concludes my prepared statement. I would be happy to address any question that the Members of the Subcommittees may have.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

STATEMENT

OF

FRANK S. SWAIN
CHIEF COUNSEL FOR ADVOCACY

BEFORE THE

SUBCOMMITTEE ON REGULATION AND BUSINESS OPPORTUNITIES
AND THE
SUBCOMMITTEE ON ANTITRUST
COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

CONCERNING

H.R. 423

THE JOINT MANUFACTURING OPPORTUNITIES ACT OF 1989

ON

FEBRUARY 27, 1989

Chairman Wyden, Chairman Eckart, and members of the Subcommittees:

Thank you for the opportunity to present this testimony on H.R. 423 - a bill to grant anti-trust protection to flexible manufacturing networks.

The SBA supports the concept of allowing U.S. businesses, and particularly small businesses, to cooperatively manufacture products for both national and international markets. I believe that legislation allowing small businesses to form "flexible manufacturing networks" would increase their international competitiveness and speed the diffusion of advanced manufacturing technologies to small firms.

I understand that the purpose of this legislative initiative is to permit informal partnerships to share equipment, facilities, research, and marketing information without triggering per se antitrust violations. Members of these networks would have their actions reviewed under the less stringent "rule of reason" standard. In addition, network participants' liability would be limited to single damages for covered activities which are found to violate antitrust laws under the "rule of reason" standard. While the bill makes the burden of proof in an antitrust suit more difficult and limits its damages, it does not completely insulate network members from liability.

The significance of small firms in U.S. manufacturing is growing. Small business enterprises comprised 98.8% of all manufacturing firms in 1986. They employed 37.4% of the manufacturing work force, a 4.4% increase over the small firm share of manufacturing employment in 1976.

Over the last ten years a general trend toward downsizing of manufacturing facilities, coupled with increasing flexibility of these facilities, has been evident. However, small firms are not rapidly shifting over to automated flexible manufacturing systems, because of the massive cost of setting up these systems. Many small U.S. firms, acting alone, cannot afford to upgrade their production facilities to include flexible manufacturing systems.

U.S. firms trail Japanese and Swedish firms in the number of flexible manufacturing systems. In the engineering industry, Sweden has 5.5 flexible manufacturing systems per hundred thousand workers and Japan has 1.9 systems per hundred thousand workers while the U.S. has only 0.7 systems per hundred thousand workers.[1]

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[1] Bo Carlsson, "The Evolution of Manufacturing Technology and Its Impacts on Industrial Structure: An International Study," Small Business Economics 1:1 (1989).

The situation is even more acute for small manufacturers. A recent SBA study found that 91% of the large manufacturing firms in upstate New York had implemented a new production process technology (broadly defined to include automation, robotics and numerical controlled machinery) in the last five years while only 65% of the small manufacturers had added any new production technologies.[2] SBA believes that small businesses need to upgrade their production facilities to compete in both national and international markets.

Small business is the most efficient sector of the economy in achieving both product and process innovations. Two studies sponsored by the Office of Advocacy have concluded that small businesses produce innovations at a rate approximately two and one half times that of large firms on a per employee basis.[3] However, these innovations are often licensed to large U.S. firms or foreign competitors because the innovating small firm lacks the funds or the manufacturing capability to bring these innovations to market.

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[2] Albert Link and Barry Bozeman, "Firm Size and Innovative Activity: A Further Examination," Prepared under SBA Contract # SBA-2069-OA-87, September 1987.

[3] The Futures Group, "Characterization of Innovations Introduced on the U.S. Market in 1982," Prepared under SBA Contract # SBA-6050-OA-82, March 1984; Gellman Research Associates, Inc., "The Relationship Between Industrial Concentration, Firm Size, and Technological Innovation," Prepared for U.S. Small Business Administration, Office of Advocacy, May 1982.

Small firms also have greater difficulty attracting capital than large firms. Office of Advocacy studies have shown that small firms' reliance on internal sources of funds (58.5%) is greater than large firms (42.8%). Small firms also use a greater percentage of these funds for plant and equipment expenditures than do large firms. At the same time, small firms are unable to get favorable rates from their external sources of capital. In fact, loan rates for small business are often higher than loan rates for large firms.

This combination of factors suggests that the government should act to facilitate U.S. firms', and particularly small firms', adoption of flexible manufacturing technologies. In order increase the diffusion of these technologies greater reliance on the private sector will be necessary. SBA is working currently with National Institute of Standards and Technology (NIST) to transfer technologies to small firms through our Small Business Development Center (SBDC) network. A pilot program with NIST has been established to transfer NIST technologies and technological assistance to small firms. NIST is the leading government agency in the field of flexible manufacturing and we hope that this expertise will be transferred to the small manufacturers who have come to an SBDC for assistance. In addition, SBA is a signatory

of the Department of Commerce's Interdepartmental Agreement to Facilitate Small and Medium-Sized Manufacturers Obtaining the Benefits of Flexible Automation Systems.

Two types of small business entities would be helped by legislation to limit antitrust uncertainty for joint activities in flexible manufacturing: 1) groups of small firms who would like to build a flexible manufacturing facility to be used for manufacturing each members' product line (a shared manufacturing facility); and 2) firms combining to produce a product or family of products on a joint venture basis. In the shared manufacturing facility, it is hoped that small firms can move up the learning curve on this new concept by becoming acquainted with flexible manufacturing equipment, training their workers to use the equipment, and developing efficient production and management techniques with the equipment. Members of these shared centers would be able to assimilate these technologies into their own facilities more quickly, while reducing their risks because of the production cost data generated while a member of the network. In the joint venture situation, small firms would cooperate to purchase equipment too costly or risky to buy themselves or to perform jobs too large for their individual production capacity.

Both types of entities have similar problems - by sharing information on manufacturing and production costs they can be exposed to antitrust challenges. Appropriate legislation could discourage vexatious lawsuits which may arise under these arrangements.

The Subcommittees should note that statutory relief for small firms should involve the simplest procedures possible. An existing provision of the Small Business Act has not been widely used by small businesses, in part because the procedures are complicated. Section 640 of the Small Business Act (15 U.S.C. 601 et seq.) allows small businesses to enter into voluntary agreements, for Federal defense procurement purposes, which are exempt from the antitrust laws and the Federal Trade Commission Act. Such agreements must be "...in the public interest as contributing to the national defense..." (15 U.S.C. 640(b)), and be approved by the Attorney General. In addition, several notifications are required and the Chairman of the Federal Trade Commission must be consulted. To my knowledge only one such agreement was ever put together. However, the process was so cumbersome that it took over six months to get the necessary approvals and consultations.

To my knowledge this consortium was not able to secure any contracts under this section of the Small Business Act. I believe a different approach is needed to achieve antitrust protection for flexible manufacturing networks.

Executive Branch agencies are actively considering the possible need for legislation to remove antitrust impediments to pro-competitive joint ventures by U.S. industry. However, as indicated in today's testimony on this subject by the Department of Justice, the Administration has not yet determined whether, or in what form legislation in this area is necessary or appropriate.

In conclusion, however, I would like to restate that SBA wholly supports the concept of establishing of joint production facilities and joint production ventures for small manufacturers. I look forward to working with the Congress to further encourage small firms to form these networks and insulate them from unnecessary litigation.

I would be happy to answer any questions from the Subcommittee.

STATEMENT

OF

ROBERT H. BRUMLEY
HUNTON & WILLIAMS

BEFORE THE

SUBCOMMITTEE ON REGULATION AND BUSINESS OPPORTUNITIES
AND THE
SUBCOMMITTEE ON ANTITRUST
COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

CONCERNING

COOPERATIVE PRODUCTION VENTURES

ON

FEBRUARY 27, 1989

Mr Chairman, Members of the Committee, thank you for this opportunity to testify before you today on a topic of timely concern to U.S. competitiveness. Mr. Chairman, I congratulate you on your interest and demonstrated leadership in this critical area.

Bringing our antitrust laws into touch with the realities of today's marketplace has been a priority of mine for the past six years. My service in the previous Administration at the U.S. Department of Commerce provided me with a unique learning experience. As Deputy General Counsel to the late Secretary Malcolm Baldrige and General Counsel to his successor, C. William Verity, I served as the department's advocate for meaningful changes to our antitrust laws, which would boost U.S. competitiveness. Accordingly, my testimony will be within the framework of that experience -- what we at Commerce learned over the past eight years about the special relationship between antitrust and competitiveness, a process which culminated in a co-authored opinion editorial by Secretary Verity and Attorney General Richard Thornburgh appearing in the WSJ on December 29, 1987. An op-ed which, Mr. Chairman, you have been kind to give broad distribution among your colleagues. Please note that I do not speak for the present leadership at the Department nor the current Administration.

First, I must say that I am not an antitrust lawyer. I am a trade lawyer. I can assure you that this is a significant distinction, especially when the topic is antitrust not trade law reform. To take some license with a famous quote of Robert Kennedy's, "Antitrust lawyers see the world as it is and say, why change? Trade lawyers see the world as it will soon be, and say, change now!"

I think our antitrust laws are similar to our tax, environmental and even our trade laws -- subject to changes in our national attitudes, priorities and circumstances. No body of law is sacred, beyond change by the will of the people. To believe otherwise restricts the law's vitality and usefulness in service to this dynamic nation in an ever-changing world. That is why, Mr. Chairman, I congratulate you and your co-sponsors of H.R. 423. Your bill preempts any debate over whether legislation should be considered in this area -- the discussion can now turn to solutions.

Over the past eight years, the Department of Commerce, working with the Administration and the Congress, promoted a number of changes to our antitrust laws. Principally, these changes dealt with forms of business organizations -- the size, shape, and range or reach of business activities -- not business conduct -- such as collusion or price fixing. The latter are the tools for tough enforcers of our antitrust laws. No one has ever suggested any change or loosening of those safeguards of

competition. Instead, we have suggested changes which were meaningful and pertinent to the parallel changes occurring in our economy. The Reagan Administration produced a number of proposals for change -- some were enacted, some were not. For example, the Export Trading Company Act of 1982; the National Cooperative Research Act of 1984, the Shipping Act of 1984; the 1982, 1984 revisions to the Justice Department Merger Guidelines and a variety of reform legislation presented in the 99th and 100th Congresses.

Central to substantially all these reforms was the understanding by the Congress and Administration that our antitrust laws are simply the rules and standards of conduct for competition and competitors in our market. As the definition of what constitutes competition in the U.S. market changes as well as the mix of competitors, the rules governing competition must change. And, Mr. Chairman, we all realize, in this era of 150 billion dollar trade deficits, our market has changed and our traditional notion of competition has changed. In short, the world has changed.

The Verity-Thornburgh initiative calls for a limited antitrust exemption as an incentive for cooperative activity. It is an answer furnished by the Nation's top lawyer to a problem presented by the Nation's top businessman. In short, it seeks to address a businessman's problem. This is a critical point which must be understood before we can consider any solution. [In

today's frenetic global market, cooperation and competition are not adversaries. Cooperation can in fact enhance competition.] Cooperative activity is fundamental in preserving our domestic market position in new products and services as well as possibly encouraging a recapture of lost market share in current technologies. I again congratulate you, Mr. Chairman, and your co-sponsors, in responding so quickly to these Cabinet Secretaries' suggestion for immediate legislative action in this area.

The Verity-Thornburgh initiative also has a proper context. It should be considered in light of the lessons learned in the last eight years with respect to markets, innovation, and the dynamics of foreign competition.

Understanding the Market

Over the past decade, radical changes have occurred in the American market. These changes have been fueled by a number of factors -- principally, a commitment to a domestic market open to all nations' products. The level of import pressure has risen to the point where 75-80% of U.S. manufactured goods are under some form of import pressure. Maintaining let alone expanding market share has become a priority business strategy. Add to this commitment an open market, aggressive foreign competition, a collapsing "shelf-life" for manufactured goods, and government-private partnerships created by our trading partners to aid in

product development production and marketing, and you can see, Mr. Chairman, the tremendous pressure a domestic manufacturer is under. That "maker of things" needs all the tools government can provide to face this level of competition. An antitrust exemption for cooperative activity is one such tool.

Understanding Innovation

The relationship between ideas and the product offered for sale was not fully appreciated by us in 1981. Like matter, technology is never in a state of rest -- it is either emerging, or declining. And it is always competing. Through the Commerce Department's Office of Productivity, Technology and Innovation (OPTI), the fundamentals of the manufacturing process have been explored and some recommendations for appropriate government action made. One was the National Cooperative Research Act (NCRA). The NCRA was supposed to be the antitrust solution to the problem of cooperative activity. And it has had some success. Its shortcomings, however, became all too apparent as soon as investors realized that the real benefit derived from cooperative R&D are profits returned after the production, distribution and marketing phase of the technology. If the protection from private suits only applies to a first phase of the "cycle" of the product, a competitor, foreign or domestic, can still disrupt by lawsuit or acquisition the development of the technology at the point where the exemption stopped. For example, Sematech -- the consortium of U.S. firms engaged in

development of more powerful and competitive semiconductor chips -- is concerned that once its R&D is complete, it will have to pursue production, distribution and marketing without the benefit of the NCRA's protection. Our trading partners know exactly where the next opportunities to "buy in" on the fruits of the consortium's R&D are, and I understand they already have begun to invest in U.S. companies which will be involved in the production and distribution of the product. This is a hard lesson, but an important one. An antitrust exemption which does not extend through the life cycle of a product, all the way from innovation to sale, is no exemption at all.

Our trading partners will assess where the exemption stops and either by suit or acquisition participate in the development of the product. Any legislative solution should ensure it does the job by covering the whole product lifecycle, all lines of commerce, and all forms of business. Competitors' can then decide to join the cooperative venture on equal terms with other participants, sharing the collective risk.

I remind this Committee also that the life cycle of a product is shrinking geometrically. It took our toughest competitor 30 years to capture a substantial portion of our automobile market. Compare that with 10 years in televisions, 5 years for semiconductors and 18 months for personal computers and you are faced with the stark reality -- as long as market remains open, no firm or product can exercise market power for very long.

The technology will be duplicated -- legally or pirated -- and will reappear as a lower-priced, possibly higher-quality unit, sometimes before the originator has obtained a return on his initial investment.

I believe this collapse of shelf-life will continue, exerting ever-greater pressure on our producers to move from concept to production to distribution to sale in the most expedient, efficient manner possible. The integration of information systems worldwide accelerates this process. The transfer of new ideas, know-how, product manufacturing, engineering techniques in a real-time sense simply adds to the existing pressure on domestic manufacturers.

Let's not repeat the mistake we made with the NCRA by attempting to "place" an exemption at the most appropriate point. Freedom to pursue all aspects of the life cycle of the product -- from the idea to the shelf -- is the safe harbor which should be created. Cooperative competition in all forms should be the standard unless or until it can be shown that the venture can exercise market power. Market power being the ability to maintain the price of the product above competitive levels for an extended period of time. Given the hard facts -- that exempted cooperative ventures will be selling in a domestic market, open to all nations; with collapsing shelf-life; and foreign, targeted trade policies -- I think the risk to competition, the kind of competition which is really occurring in our market, is minimal.

The consequences of losing the advantages derived from exempted cooperative competition are too great to consider.

Understanding Foreign Competition

Mr. Chairman, I know this Committee is very much aware of the level of foreign competition U.S. firms face. I simply want to make the point that competition with Japan Inc. and soon Europe 1992 requires the greatest flexibility and innovative skills of our business community. We all know that U.S. firms face the distinct industrial policies of our trading partners. The choice is a simple one for U.S. policy makers -- practice industrial policy or seek other alternatives. The least intrusive, best alternative is to continue to loosen our domestic competition laws to provide maximum flexibility to the U.S. businessman trying to compete for his own market share. I do not believe in closing markets or a national industrial policy. But if our rules for competition become out of date, or unresponsive to change, then soon there will be no other choice.

The Solution -- An Antitrust Exemption for Cooperative Competition.

Mr. Chairman, you have sponsored the first legislation in response to the Verity-Thornburgh initiative. I suggest a three part test, drawn from the above lessons learned, to be applied to H.R. 423 as well as the recently filed Boucher/Campbell proposal.

The solution should be simple and clear. It should be a business-oriented solution to a businessman's problem. The complaint I often heard at Commerce from the business community was the lack of understanding in business terms of our antitrust laws. The Expert Trading Company Act may be a model of clarity to follow. The procedure is simple; the process can be changed by public rulemaking, not legislation. It also allows the Commerce Department to serve as an advocate with the antitrust division, relieving the Justice Department from being both an enforcer of law and a promoter of exemptions. This Committee should consider such a procedure to determine not only its effectiveness but also its intrusiveness. I do not believe in replacing one regulator with another.

A second factor to be considered is whether the protection to be offered -- a safe harbor from all suits by a certificate of exemption or a limited exemption subject to suit only for actual damages -- does the job for everyone. The protection afforded should not benefit one group over another. It should apply to all products, activities, or company of any size, including "declining" as well as emerging industries, which face foreign competition that is every bit as stiff. Let's do the job this time and provide the kind of advantage that our trading partners enjoy.

Finally, please consider the flexibility of the exemption. It should not require continued adjustment to meet changing

market conditions. As changes occur, let public rulemaking be the vehicle for change. I think you gain considerable flexibility when you state your policy in clear simple terms and delegate implementation to the open and highly interactive process of public rulemaking.

Conclusion

After eight years, we have learned a great deal about markets, innovation and the dynamics of foreign competition at the Department of Commerce. The new team has the benefit of this experience. As for the Verity-Thornburgh initiative, the policy between the Nation's top lawyer and businessman has been stated. They agree some form of exemption is necessary. An innovative solution is required and, Mr. Chairman, your proposal is the first to answer the call. We should reject the notion that some suggest that everything is fine or that the antitrust laws are once again under attack. This is no longer a question of morality -- should we change; it is a necessity that we change now.

Thank you for the opportunity to be here today. I would be happy to take any questions you might have.

STATEMENT BY

WILLIAM C. NORRIS
FOUNDER & CHAIRMAN EMERITUS
CONTROL DATA CORPORATION
CHAIRMAN OF THE BOARD
THE WILLIAM C. NORRIS INSTITUTE

BEFORE THE

SUBCOMMITTEE ON REGULATION AND BUSINESS OPPORTUNTIES
OF THE
COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

FEBRUARY 27, 1989

WILLIAM C. NORRIS INSTITUTE

A6133-1 Rev. 11/77 ⊕ 79

PRINTED IN U.S.A.

Statement by William C. Norris

Having long been an advocate of expanded cooperation in our society, I am pleased to see the initiative by Congressman Wyden and others sponsoring legislation to amend antitrust laws to lower barriers to cooperation in manufacturing and in other areas.

Before providing specific thoughts with respect to H.R. 423, I should tell you about my current activities to advance cooperation in manufacturing being carried on under the aegis of the William C. Norris Institute, of which I am Chairman.

Briefly, the mission of the Norris Institute is to catalyze public/private cooperation to address major unmet or poorly met societal needs. The only way these will be adequately met is through cooperation to more efficiently utilize our scarce resources.

However, in American society, we have yet to establish a culture of cooperation -- while there is movement toward more cooperation, we are prone to compete among ourselves than cooperate. As a consequence, it usually takes a catalyst to get organizations to cooperate to the required extent, and that is a major function of the Institute. In order to implement a number of Institute initiatives, consortia are being formed comprised of representatives of applicable public/private sectors who come together to help shape the direction of the initiative, agree on a common statement of principles and develop a strategy for action and implementation.

AIMSCP

The WCNI program in advanced manufacturing is called the Advanced Integrated Manufacturing Services Center Partnership. It is a nationwide cooperative program for accelerating the widespread utilization of computer-aided design and computer-integrated, flexible manufacturing systems, especially by small and medium-sized companies.

The major impetus for the program is, of course, that U.S. industry is not getting advanced manufacturing technology in use soon enough by either most large or small companies.

There are numerous reasons for this condition. They include the reluctance of many manufacturing companies to accept the gravity of the threat from overseas and the low level of relevant technical capabilities in most manufacturing companies. In the case of smaller companies, the substantial investment required

is unaffordable, along with unacceptable high risk due to uncertainty in predicting demand for products manufactured. Additionally, small firms will not usually be able to justify the multifold capacity increase resulting from the investment in an automated facility.

There are a number of ways for helping to overcome those barriers which include:

- o Consulting assistance
- o Education and training; which includes demonstration centers
- o Shared ownership of manufacturing networks
- o Flexible manufacturing networks, which include cooperation in one or more additional areas, such as marketing, purchasing and accounting. (A common manufacturing facility, with shared ownership, may or may not be utilized.)
- o Manufacturing service centers

Further, in determining the most effective ways to help smaller companies utilize advanced manufacturing technology, it must be kept in mind that there are three types of companies to be served:

(1) parts manufacturers (job shops)
(2) product manufacturers
(3) start-up manufacturing companies

Considering the spectrum of companies with varying manufacturing technology needs, it is clear that manufacturing services centers merit the major emphasis because that approach offers the best answers to the problems of high initial cost, risk and capacity utilization faced by small and medium-sized companies. In fact, availability of manufacturing services will facilitate the formation of shared ownership manufacturing networks because the cost and risk can be assessed before a commitment to the required investment is made. In addition, consulting and education and training can be much more productive.

AIMS Centers Network: the essence of the program for the implementation of the services approach is the establishment of a nationwide network of various types of Advanced Integrated Manufacturing Service Centers, abbreviated AIMS Centers.

They would perform design and manufacturing on a service basis where companies pay for the service as it is used with no

investment required in center facilities. Each company would utilize the center through a workstation on its own premises connected by a telephone channel. At any time, a company can license all or part of the manufacturing system for use on its own premises -- or a group of companies can set up a shared manufacturing facility.

Telecommunications will link these centers, which will use a common set of standards for computer software, data bases and communciations protocols.

Currently, the AIMS Centers partnership has a relationship with three Advanced Manufacturing Center Networks in the planning and formation stages:

- Advanced Manufacturing Network - members are community organizations in Pennsylvania, California, Minnesota and Mississippi.
- North-Central Regional Advanced Integrated Manufacturing Service Centers Partnership - members are community organizations in Illinois, Minnesota, Kansas, Nebraska, North Dakota and South Dakota.
- Minnesota Advanced Manufacturing Technology Centers - members will be community organizations in six regions of the state.

FLEXIBLE MANUFACTURING

Also relevant to the hearing today, is a study by the AIMS Center Partnership, possibly in cooperation with the Northwest Area Foundation to identify potential shared flexible manufacturing networks within the State of Minnesota. Sectors which could benefit from the approach include plastics injection molding, die casting, composite materials and products, medical instruments, wood products and food processing.

Problems: The problems attendant to establishing a shared manufacturing network, of course, can vary greatly, depending upon what is manufactured. Ordinarily, a facility for producing products will cost much more than for making parts. even a shared facility for manufacturing parts will be difficult for many groups of small companies to finance.

In addition to the cost barrier, there is the fear of antitrust, which is being addressed here today.

H.R.423

I will now comment on H.R.423 and first note that I am pleased

to see that the proposed legislation follows the pattern of the National Cooperative Research Act of 1984, because that approach has been very successful. More than one hundred R&D cooperative ventures have been formed, and I believe that number is far larger than what most people thought it would be.

However, I am concerned that the proposed legislation departs significantly from the Cooperative Research Act in two respects. The bill would apply only to companies with 500 employees or less and to groups of companies having less than a 20% market share in the relevant market.

While I understand the concern by many about making exemptions from the antitrust laws, of course, neither the Cooperative Research Act nor H.R.423 exempt anything. Treble damages are reduced to single damages, and the rule of reason applies, rather than the per se rule. Thus, penalties would still be severe enough to deter undesirable, anticompetitive activities. However, by tacking on a 20% market share restriction, ambiguities are created.

Defining a relevant market -- what product and what geography -- is a very wishy-washy process. It can be global or a single metropolitan area, covering a narrowly defined or a broadly defined product. It can depend, to a great extent, on who is paying the economist. Consequently, there is not going to be the certainty that a small business has to have and the cost of a legal opinion will be burdensome.

With respect to the 500 employee limit, it appears to me that company size is irrelevant from an antitrust point of view. At the same time, it may create a situation which precludes the right combination of people and resources being brought to bear for success in a certain area. As we know, key elements to successfully bring a product to market are uniqueness in design and efficiency in manufacturing it. The underlying genius for these functions is found in a handful of people -- not a large number. If that nucleus is in a 600-person company, it wouldn't be eligible for a cooperative effort with other companies.

Earlier, I mentioned the study by the AIMS Centers Partnership in Minnesota to identify potential shared flexible manufacturing networks. One of the first being analyzed is a group of seven companies in a community with a population of 26,000. There is interest among all the companies in cooperation. Two of the companies have over 1,000 employees. One of the larger companies has the most important technology for a successful cooperative effort. The other companies are much smaller. There is a need for cooperation, because growth has leveled off for several of them. However, H.R.432, as now structured, would preclude the formation of the best combination for a cooperative effort. Nor is it likely that the small companies by themselves

can finance the establishment of a shared manufacturing facility, even if there is an adequate amount of expertise among them.

Furthermore, it is not likely that many other similar groups of small companies can marshall the financing to set up a shared manufacturing facility nor prudently assume the risk of utilizing its increased capacity. Or conversely, in many areas, I believe that the number of shared manufacturing networks that will be established will be much greater if there is no limitation on company size under H.R. 432.

There's always some risk in virtually any major action in our complex society. In a fiercely competitive world economy, in which the U.S. is losing market share in industry after industry, antitrust isn't a significantly relevant factor in helping to stem the erosion. Thus, a prudent decision, it seems to me, would be to make whatever adjustments to the antitrust laws that may be necessary in order for industry to best respond to the challenge of foreign competition.

Let me conclude by again applauding your efforts. Not only is it important to amend antitrust laws to remove unnecessary barriers to cooperation, such action will help create a greater awareness by business of the urgent need to accelerate the adoption of advanced manufacturing technology.

k367/2/22/89

National Tooling & Machining Association

NTMA
PRECISION

BEFORE THE

SUBCOMMITTEE ON REGULATION AND BUSINESS OPPORTUNITIES

AND THE

SUBCOMMITTEE ON ANTI-TRUST

OF THE

HOUSE SMALL BUSINESS COMMITTEE

TESTIMONY

OF

MATTHEW B. COFFEY

PRESIDENT

NATIONAL TOOLING AND MACHINING ASSOCIATION

FEBRUARY 27, 1989

9300 Livingston Road • Ft. Washington, Maryland 20744 • (301) 248-6200

I am here today on behalf of all the member companies of the National Tooling and Machining Association (NTMA).

NTMA is a non-profit organization composed of nearly 3,200 contract precision machining, tool, die, mold, diecasting die, and special machining companies throughout the United States. NTMA serves as the voice of this $20 billion a year industry. Although this is a large figure, our member companies are small. Sixty-five (65) percent of our member companies have 20 employees or less. This is reflective of the industry which predominately is made up of small businesses. Only a scant three percent of our members employee 100 people or more. So, in a very real way, our association is reflective not only of the tooling and machining industry in the United States, but the industry itself represents small business in America. The same characteristics of hard work, ingenuity, aggressiveness, a fierce sense of pride and competition, that thoroughly inhabit our machine shops, are found in U.S. small business.

It is important to explain just how our industry touches the lives of all Americans. First of all, tooling and machining is at the very heart of all U.S. manufacturing. Virtually every single product that is manufactured is shaped by tools, dies, molds, precision machining and special machines. All U.S. produced items made by machining are affected. Parts for car engines, planes, tanks, jets, ships, silverware, cookware, ball point pens, medical and

laboratory equipment, aerospace, weapons, locks, nuts, bolts, almost everything imaginable. Custom designed equipment used to manufacture products is referred to as "special tooling." This tooling is used in presses and molding machinery and allows the rapid mass production of thousands and thousands of precision manufactured parts and components.

Because of the make up of the companies represented by our Association, we are able to get a realistic gauge of American business. We continuously take the pulse of the industry to see what small business feels about various issues of national importance. After all, the men and women who own, operate and work in small businesses form the very backbone of this country.

The industry is composed of over 12,000 separate companies. Of these companies, eighty percent employ under 20 people. A typical company will have eight or nine skilled craftsmen and a clerical staff of one or two people. The industry is almost totally owner-managed. It is not unusual to see many of the companies run by families, being handed down to each generation. And with each passing, the qualities of independence and competitiveness are likewise passed along.

So, unlike the other manufacturing industries in the U.S., our companies truly reflect "small business" in much the same way that other non-manufacturing companies do such as retail shop owners, service connected businesses, etc.

Diversification is a characteristic that can be applied aptly to our industry. This is because practically every job that is performed by each of our companies has to be individually customized to meet the particular requirements of the customer. Thus, with such special needs to be met, such customized jobs do not easily lend themselves to mass production. Customized work often times demands creativity and innovation for new designs, new techniques, new theories and finding new ways to improve and refine production components. In order to accomplish this, industry workers must be the very best and possess skills in engineering, mathematics and technical design; they must be fine craftsmen in the classical sense of the word. These qualities are absolutely essential when one is discussing the production of products involving extremely close tolerances of 1/10,000th of an inch or even less. Yet, such work is done on a daily basis. With such a wide range of activities, it is understandable that our industry, in a collective sense, represents a cross-section of America. On the other hand, our shops tend to be, on an individual basis, focused in areas of such concentrations as aerospace, defense, automotive, oil and medical. We work for literally every industry in the United States and as such represent the entire economy. This versatility can be seen in our responsiveness to our customers. Their needs are normally in a state of flux because many of them are themselves manufacturers and must respond to the changing needs and

technical requirements of the ever evolving world of high technology.

In summation, the complexion of our industry is entrepreneurial and is expected to remain that way. It is a collective industry of individual, small-scale operations with close-in, hands-on participating management.

This bring us to the issue at hand and the compelling reasons for our support and endorsement of H.R.423, the Joint Manufacturing Opportunities Act of 1989.

The nature of our industry is oriented to small business. Because of the individually customized aspects of the work we do to suit the particular needs and requirements of each of our customers, we are a very competitive industry. For the 12,000 companies in our industry, competition is a way of life. We relish the spirit of competition, we welcome it and we thrive on it. We compete against each other for every bit of business we get. The end result of the competition is that we are continually under pressure to refine and improve everything we do in order to stay competitive and to stay in business. Methods are always being sought to increase the quality of our work and seek cost effective innovation. Only those companies that maintain the highest skills levels, and management practices will survive.

It is not surprising then that our members are very independent businessmen. They manage every aspect of their businesses and take personal responsibility for each decision made. This process includes decisions concerning quality, expansion, competition, management, service and economics. Our owner-managers take full responsibility for their decisions. They accept the good with the bad. They can't blame anyone else but themselves. They have all learned the lesson of the necessity of adapting to change in order to survive and remain competitive and alive.

The challenges to this way of life are strong and are getting stronger every day. The independent businessman is finding that it is increasingly difficult to face these challenges alone, as he has always done in the past. Permit me please to examine more closely some of these challenges, the effect they are having on our industry and what we can do about them.

As I stated to the Subcommittee last year, our industry is in the process of massive changes which challenge the innovation, management skills and financial resources of our member companies. They are being challenged to change their process technologies, which have undergone rapid conversion from old-line mechanical controls and mechanical cutting to computer-driven equipment which includes robots, laser machine tools and computer integrated manufacturing work cells. They are challenged to adapt to the rapidly changing demands of their customers as those customers also undergo

rapid technological change and a restructuring in they way they do business -- new processes, new materials, finer tolerances and specifications and new business locations.

Not to be overlooked are the challenges from international competition.

While there has always been some foreign competition in several sectors, over the past few years there has been a significant increase in both direct and indirect foreign competition. We have seen the competitive environment change rapidly and substantially because of the movement off-shore of major U.S. manufacturing facilities with the corresponding purchase off-shore of the supporting tools, dies, molds and precision parts. Also, the development of increasingly high-level technical expertise and skills by foreign firms (largely as a result of past U.S. policies to strengthen these foreign economies). Another major challenge is the favorable economics of foreign firms based on such factors as government subsidies, lower cost of capital, lower employee wage and benefit costs, substantially fewer mandated costs imposed by government regulation and the development of flexible manufacturing networks.

All of this has culminated in some very serious problems for our industry. While our members welcome free and open competition, these factors have significantly changed certain segments of our industry. They have placed

unrealistic capital burdens on our small, owner-managed businesses. Our industry now appears to be under intense attack from many corners of the globe -- molds and dies from Japan and Taiwan, molds from Canada and Portugal, and so on. Because we are are such a fragmented industry, dealing in thousands of narrow niches, our companies are highly vulnerable to targeted attacks. And that is what is happening right now. Our companies are being picked off on many narrow fronts simultaneously. These are specialized areas and it difficult to get an aggregate picture of the magnitude of the assault. But it is a fact and it is happening every day. And because our members are each so small, they have little to fall back on if their major area of expertise and client base is undermined in such a manner.

What can be done to help this situation? What can be accomplished within the industry to preserve and enhance the skills, technology base, innovation, and the competitive position of this industry? We feel that the passage of H.R.423 is a good start. We feel that the successful application of flexible networking in small U.S. manufacturing companies is a way to stop the erosion of this vital industrial base. To do nothing is tantamount to being part of the problem.

The concept of flexible manufacturing is not brand new, nor is it uniquely American. But it is a concept that has proven to be successful and is growing. There has been some limited American experience with the concept during the last

10 years or so, but the most convincing demonstration of its workability is the example in northern Italy and the other parts of Europe. According to Mr. Robert E. Friedman, President of the Corporation for Enterprise Development, the Emilia-Romagna region of Italy, with a little under 4 million inhabitants, has shown an increase in manufacturing employment in the last 15 years (20,000 employees were added to key industries including metalworking and machining). Wage rates went up to 175 percent above the Italian average and the region moved from 17th in per capita income in 1970 to 2nd in 1985. The region contains 325,000 small companies which includes 90,000 small manufacturing firms; this equates to one company per every 5 active members of labor force. Ninety percent of the 90,000 manufacturing companies had less than 22 employees. Thirty-nine percent of the total workforce is self-employed. Most of the small, highly specialized firms use advanced, computerized equipment with highly skilled workers to produce high quality parts and components which in turn are exported to countries all over Europe, the United States and the Far East.

Metalworking in this particular region of Italy is a great success story but it is not an isolated one. Other manufacturing networks have, in turn, sprung up in other regions in Italy and are doing very well. Manufacturing networks have now spread into Germany, Sweden, and Denmark. The conclusion is that this is not simply a temporary phenomenon or a flash in the pan. Each network has grown and prospered in each area (areas which are dissimilar in

their political and social institutions), which lends credence to the fact that their success is more in keeping with the demands of an ever growing global economy rather than the particular situations which gave rise to each. We need to realize that small manufacturers both here and abroad are entering a new age of international business and competition.

Thus, it is easily seen that from the perspective of small manufacturers, flexible networks offer enormous possibilities which address significant competitive problems faced by small U.S. manufacturing businesses.

The rapid technological evolution has a tremendous impact on small manufacturers. First, small manufacturers have to be able to gain access to increasing amounts of capital, and second, increased requirements for access to training. Investment in new technological equipment is very expensive. The average investment in equipment has gone from less than $100,000 ten years ago to $2.2 million on the average today. Most small U.S. manufacturers try to stay competitive by taking advantage of preferential terms and rates offered by foreign machine tool manufacturers. This is not a preferred method but one that is driven by a lack of realistic and viable alternatives. Domestic banking houses require substantial collateral on assets which can be liquidated rather than providing finance capital on equipment productivity. This practice greatly restricts the ability of the small manufacturer to get the loans he needs to

operate his business successfully. To overcome this problem, we feel that loan guarantees should be backed by the government, or, if not, Congress should allow flexible manufacturing networks to negotiate on behalf of the companies involved. Such action is necessary to encourage start-up and expansion or even to allow it to happen.

One other aspect I will touch on is training. Currently, there is a national shortage of highly skilled workers. We must have strong training and educational institutions which are guided by industry to produce the quality craftsmen required now and in the future. People who are not only skilled in the performance of their jobs or special equipment, but who are knowledgeable in new technologies and theories as well. Such training, if supported through flexible manufacturing networks, can produce the needed personnel to build such a manpower pool. Such effort will reduce the weakness of small companies and build on their strengths. Local communities can become involved in the process and identify new career goals for students. A progression from technical student, to journeyman to small business owner can be seen and achieved. This has been done is Europe and it can be accomplished here. The jobs are there. The jobs need to be filled. These are the highest paying blue collar jobs in the United States. There are thousands of success stories just waiting to happen; we want them to happen. .

One other aspect of H.R.423 should be discussed concerning anti-trust restrictions. Prior to the successful implementation of the principle of flexible manufacturing networks, legal provisions must be made which will allow networking to operate without strangling in unnecessary restrictions. H.R.423 does a very good job in spelling out what activities can be encouraged by flexible manufacturing networks. This articulation is necessary because of the "inbred " fear of stepping over the boundary of anti-trust restrictions. This industry attitude is the result of years such anti-trust restrictions which have in turn made most of our small companies "gun shy" in that now a mental attitude has developed which makes our small companies afraid of engaging in any practice even remotely looking like an anti-trust violation. While such an attitude is not in and of itself bad, a clear statement of what is allowed is needed in order for small manufacturing firms to be absolutely sure that they are operating within the prescribed limits of the law. We feel that H.R.423 is adequate in that regard. They must overcome the years of fear that the anti-trust lawyers have instilled in the manufacturing community. That fear has stymied growth, made companies less competitive both in the U.S. and abroad. Remember the challenges we are up against. We must be able to compete against a European flexible network or a Japanese Ministry of Trade Industry targeted industry development program.

It is clear that to encourage flexible manufacturing networks in the United States, Congress must take the action now to remove those barriers presently imposed by the anti-trust laws. That action can be similar to those actions already taken in the Export Trading Company Act and the Research and Development Consortium Amendments. Some sectors may view this as a major revision of the laws because a flexible network does, in fact, require the sharing of capacity information, and pricing information for the preparation of a successful bid. Since the networks normally will be bidding against large companies which employ extensive legal staffs, we would expect those companies to file anti-trust challenges as a matter of course to prevent competition, unless the law is very clear. In that regard, I would like to offer as suggestions, two areas of the bill which we believe should be fine tuned somewhat. First, so far as ownership and control relating to the companies comprising a network, it should be perfectly clear that the formation of subsidiaries by large businesses for the purposes of invading the network is prohibited by the bill. In regard to lawsuits, settlements and recovery, any offsets should apply equally to damage provisions and attorneys fees alike.

In conclusion, I urge you to join with the members of our industry in supporting H.R.423. The concepts therein are eminently workable, have been tried successfully and proven to be sound under a number of conditions. This is legislation that is not politically oriented toward either

party, but is oriented only toward helping American small business. The concept of flexible manufacturing networks has been supported by the Secretary of Commerce and the Attorney General. We believe that any objections to any provisions in the bill can be worked out to the satisfaction of all affected parties. However, at this point, we have heard of no objections.

NTMA stands ready to continue in its role to aid and assist in every way possible those programs which will continue to enhance, improve and strengthen the United States economy. In furthering this effort, we urge your support in securing the passage of H.R.423. Thank you.

REMARKS OF JOE SIMS CONCERNING JOINT MANUFACTURING AND JOINT MARKETING ARRANGEMENTS BEFORE THE SUBCOMMITTEE ON ANTITRUST, DEREGULATION AND PRIVATIZATION AND THE SUBCOMMITTEE ON BUSINESS OPPORTUNITIES AND ENERGY OF THE HOUSE COMMITTEE ON SMALL BUSINESS

February 27, 1989

Chairman Eckart, Chairman Wyden and members of the House Small Business Committee, I wish to thank you all for inviting me to discuss H.R. 423 and the antitrust issues involved in joint manufacturing and marketing arrangements. Today, more than ever before, American companies of all sizes are facing a common challenge: how to remain competitive in what has increasingly become a global marketplace. Obviously, if existing antitrust laws in any way inhibit the formation of strategic partnerships which enable domestic firms to match the efficiency and productivity of their foreign competitors, we should fix the problem. Accordingly, the issues underlying H.R. 423 and similar legislation are both timely and well worth the attention of Congress.

Antitrust has been one of the cornerstones of the American free enterprise economy. The basic premise of antitrust is that open markets and unconstrained competition will produce the highest quality goods and services at the lowest possible prices. Antitrust, therefore, extolls the virtues of independence and competition, while questioning the wisdom of coordination and joint activity. Although antitrust has served us well in the past, the globalization of our economy and the spector of foreign competition have caused some to question the wisdom of some of our antitrust rules. The antitrust laws are neutral as to who will be the winners and losers in the U.S. economy. But what if the competitive winners are Japanese? Or German? Or Korean? Or Swiss? Do we as a nation want to continue to use antitrust as our basic economic regulator even if the result is an economy dominated by foreign companies?

Obviously, these issues can be over-dramatized. Antitrust in most instances does not place domestic producers at a competitive disadvantage relative to their foreign rivals. Indeed, many would argue that it is the competitive spur produced by antitrust enforcement that generates efficient, well-managed American companies that can survive and prosper against foreign competitors that are part of or directly assisted by their governments. It may be, however, that due to global economic pressures, American consumers are now willing to take greater antitrust risks if they lead to more competitive American efforts in the world economy.

This was really the basis for the passage of the Export Trading Company Act of 1982. That legislation created a procedure for U.S. companies to obtain antitrust protection for certain joint export activities, with the goal to become more competitive in world markets. We took another step in the same direction in 1984 with the passage of the National Cooperative Research Act, which grants antitrust protection to certain cooperative research efforts. By permitting joint export activities and cooperative research, U.S. companies were allowed to pool resources, spread costs over larger sales bases and achieve economies of scale. You could find widely varying opinions as to whether those procedures have had the desired effect, but there does not appear to be any basis for concluding that the net effect has been negative. Therefore, it is worth discussing whether this same technique could be used to encourage joint manufacturing.

The Current Legal Treatment of Production and Marketing Joint Ventures

The legal treatment of joint ventures is a complex and somewhat confused area under the antitrust laws. Much of the legal confusion stems from the fact that joint ventures rarely, if ever, fit neatly into any of the established antitrust pigeon holes. On the one hand, joint ventures partially integrate the productive assets of the parent firms and therefore resemble mergers. On the other hand, to the extent that the parents continue as independent competitors, joint ventures resemble ordinary contracts.

This characterization problem has lead the courts to analyze joint ventures under both the structurally oriented standards of Section 7 of the Clayton Act and the conduct proscriptions of the Sherman Act. The Clayton Act analysis focuses upon the degree to which the venture concentrates economic power, thereby lessening competition in a relevant market. The Sherman Act analysis focuses upon whether the venture serves as a contractual mechanism for directly eliminating competition between the parent firms. Accordingly, the precise legal treatment a joint venture will receive under the antitrust laws depends upon the scope and nature of the venture.

The 1984 Department of Justice Merger Guidelines set forth the most widely accepted approach for analyzing joint ventures among direct competitors under the Clayton Act. Although the Merger Guidelines reflect the gradual movement away from a

purely structural approach to analyzing mergers, market structure continues to be the single most important variable in determining the legality of a particular combination. The Merger Guidelines establish a series of structural screens that determine the level of antitrust scrutiny a joint venture will receive. Generally, joint ventures involving unconcentrated markets or very small participants will not attract significant antitrust enforcement interest. As concentration or the market shares of the parties increase, however, so does the level of antitrust concern. Under the Merger Guidelines, joint ventures in highly concentrated markets are likely to be challenged absent strong nonstructural evidence supporting the transaction.

Joint ventures among direct competitors raise four basic concerns under the Sherman Act. One type of concern is that the venture may merely be a "sham" device for cartelization of an industry. Certain joint ventures involving significant portions of concentrated industries have been condemned as per se restraints under this theory. See, e.g., Citizen Publishing Co. v. United States, 394 U.S. 131 (1969); United States v. Sealy, Inc., 388 U.S. 350 (1967); Timken Roller Bearing Co. v. United States, 341 U.S. 549 (1951). The Supreme Court's decision in Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1 (1979), analyzing an industry-wide joint licensing scheme under the rule of reason, casts some doubt over the continuing applicability of the per se doctrine to broadly structured restraints undertaken in the context of

joint ventures. Some more recent cases, however, have found per se violations in such situations. See, e.g., United States v. Columbia Pictures Industries, 507 F. Supp. 412 (S.D.N.Y. 1980), aff'd without op., No. 81-6003 (2d Cir. Apr. 7, 1981). But see National Collegiate Athletic Assn. v. Board of Regents of the University of Oklahoma ("NCAA"), 468 U.S. 85 (1984) (applying the rule of reason to alleged price-fixing/group boycott scheme on the ground that certain restraints were necessary to offer the product).

A second type of concern is that a venture may operate to deprive nonparticipating competitors access to an essential facility. See United States v. Realty Multi-List, Inc., 629 F.2d 1351 (5th Cir. 1980); United States v. Columbia Pictures Industries, supra. This type of concern, however, will arise only in somewhat unique situations. The courts have been somewhat circumspect in declaring something an essential facility, without which nonparticipating firms are foreclosed from competition.

The third type of concern is that certain ancillary restraints necessary to effectuate the venture may unduly restrain competition. The line of demarcation between restraints reasonably necessary to effectuate the venture and restraints merely adopted to facilitate cartelization is sometimes unclear. For example, an argument can be made that the restraints at issue in the Sealy case discussed above were ancillary to the joint venture. The mode of analysis suggested

in the Supreme Court's opinion in Broadcast Music and confirmed in the NCAA case draws the line according to the perceived purpose of the venture. If the venture creates a new product or expands output, limited, reasonably necessary restraints may be tolerated. On the other hand, restraints that merely allocate market positions in existing output will probably be condemned.

The final type of concern is that the parent company cooperation needed to form and manage a venture may "spillover" into areas in which the parent companies remain competitors. This concern, though frequently discussed in the academic literature, has not prompted much litigation. I am aware of no case in which a venture has been successfully challenged solely on the basis of possible spillover effects. However, the Federal Trade Commission's review of the GM/Toyota manufacturing joint venture focused heavily upon spillover issues, and many of the provisions of the resulting consent order are designed to keep any parent company cooperation within the confines of the joint venture. See General Motors Corp., 103 F.T.C. 374 (1984).

As the foregoing demonstrates, there are a number of potential issues to consider in forming a joint venture, and the legal standards in this area are not very clear. There is considerable flexibility under the existing antitrust laws to engage in joint manufacturing; GM/Toyota is the best illustration. It is also clear, however, that certainty is

very elusive in this area, and less sophisticated companies and counsel might reasonably perceive more problems than actually exist.

Policy Issues Relating to Production and Marketing Joint Ventures

If one assumes that economic efficiency is the highest goal of antitrust, antitrust regulation should be flexible enough to permit output-expanding joint venture arrangements. The problem, however, is one of characterization. An antitrust skeptic might argue that it is possible to characterize any cartel arrangement as a joint venture, such that any substantial relaxation of antitrust standards governing joint ventures would render the Sherman Act a nullity. An antitrust cynic, on the other hand, might argue that virtually all joint venture arrangements have an element of efficiency, such that any substantial impediment to the formation of joint ventures also impedes the pursuit of efficiency. Obviously, the truth lies somewhere between the two extremes. How then does one go about distinguishing between anticompetitive and procompetitive joint venture arrangements?

The analytical approach set forth by the Supreme Court in the Broadcast Music and NCAA opinions provides a good starting point. In those cases, the Court ignored simple questions of characterization and went to the heart of the matter -- i.e., what were the parties attempting to accomplish through their joint venture arrangement? In Broadcast Music, the Court

concluded that the parties were in effect attempting to create a new product through their blanket licensing scheme. Because the product could not exist without joint action by the parties, their arrangement was not per se unlawful. In NCAA, the Court concluded that joint activity was necessary to offer competitive college athletics, but that certain of the parties' ancillary restraints were not necessary to achieve the legitmate purposes of the venture. In that case the basic arrangement was lawful, but certain of the ancillary restraints were not.

The same type of analysis should be used to evaluate joint production and marketing arrangements. As a threshold matter, one should inquire as to whether the joint arrangement is necessary for the parties to achieve some procompetitive goal. In some instances, joint manufacturing may offer opportunities to achieve efficiencies that no single producer could achieve on its own. For example, the economics of production in a particular industry may be such that small plants are incapable of achieving necessary economies of scale. Joint production, therefore, may be beneficial. Joint marketing arrangements may offer similar economies. In some industries, economic efficiency may favor joint manufacturing and joint marketing. In others, joint manufacturing may be beneficial from an efficiency standpoint without joint marketing.

The Broadcast Music/NCAA analytical approach also provides appropriate treatment of ancillary restraints. To the extent that the restraints are reasonably related to effectuating the

procompetitive aspects of the venture and are no more restrictive than necessary to achieve that purpose, reasonable ancillary restraints are permitted. It is only when ancillary restraints are over-reaching in purpose and scope that they are condemned.

Possible Legislative Approaches

Having said all this, it is still true that these cases are complex and highly fact-specific. No doubt some plans or possibilities are abandoned or never pursued because of uncertainty. Thus, the legislative issue is whether some procedure, or some safe haven, should be adopted that will alleviate this uncertainty and encourage the formation of more such ventures. The risk is obvious: too broad a safe haven would immunize anticompetitive conduct, and consumers would be injured.

The National Cooperative Research Act stopped at research and development; any commercialization of the results was left to ordinary antitrust review, under ordinary standards, for just these reasons. H.R. 423 would move one more step and would provide some (but not total) protection to at least some joint manufacturing and marketing efforts.

It is very difficult to object to this approach. H.R. 423 retains the possibility of antitrust challenge, but simply mandates rule of reason analysis. The bill then limits any damage action based upon notified conduct to actual damages (plus attorney fees and costs) -- another approach patterned

after the National Cooperative Research Act. Finally, it permits the award of attorneys fees to prevailing defendants, which would discourage frivolous actions.

H.R. 423 has many problems, including whether it should or reasonably could be limited to "small" business; whether the activities that are to be covered are sufficiently described as to be meaningful; how market shares could realistically be calculated by the parties; whether the exclusions are overly broad to accomplish the purpose of the legislation; and most basically, whether this approach provides enough protection from antitrust attack to really encourage very much additional joint venture activity.

All of these issues would have to be discussed and debated before Congress adopted such a procedure, but these are mostly details that probably could be dealt with. A procedure such as that contemplated by H.R. 423 would certainly be considerably easier to manage than something similar to the certification program of the Export Trading Company Act. If the objectives can be accomplished with a notification rather than a certification process, this would be highly desirable.

I would be happy to answer any questions you might have.

Joe Sims
JONES, DAY, REAVIS & POGUE
Metropolitan Square
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3863

Testimony
of
Robert E. Friedman,
President, Corporation for Enterprise Development

before the

Subcommittee on Regulation and Business Opportunities
and the
Subcommittee on Antitrust
of the
Committee on Small Business
of the
United States House of Representatives

Hearing on H.R. 423 --
The Joint Manufacturing Opportunities Act of 1989

February 27, 1989

Mr. Wyden, Mr. Eckart, and Members of the Subcommittees:

I want to thank you for sponsoring and holding hearings on this important legislation, and for inviting me to testify before you.

In hearings held last fall, other witnesses and I described the flexible enterprise networks of Europe, and the promise we think they hold for increasing the competitiveness of American business, and the living standards of Americans. I will not repeat those reasons here, though I would be happy to respond to questions about the phenomena and its significance.

At those hearings, several of us identified barriers to the growth of networks in the United States, including the fear of antitrust prosecution. The introduction of H.R. 423 -- The Joint Manufacturing Opportunities Act of 1989 is a timely and important response to both our concerns and our hopes. I want to thank and congratulate all of you who introduced H.R. 423 for this important act of economic leadership. I wholeheartedly support the intent of this proposed legislation.

As you know, H.R. 423 grows out of an almost decade-long series of attempts to adapt the purposes of antitrust legislation to the realities of today's global economy. It is closely patterned on the construction of the Joint Research and Development Act of 1984 (Public Law 98-462, 98 Stat. 1815).

But there are important differences between a research joint venture and a flexible enterprise network, which require, I believe, a somewhat different legislative construct. Let me clarify some of those distinctions before recommending some amendments to the proposed legislation.

First, we need to be even clearer than the legislative precursors of the current legislation, that the nature of competition in the economy has changed, and with it so must the means we use to ensure competition. The economy is now truly global, with most of our goods and services exposed to international competition. We can no longer fairly consider market concentration within the confines of national boundaries. Our best defense against market concentration and domination is a good offense -- the rapid start-up and growth of new firms, the opening of new markets. Any antitrust law or regulation which inhibits the willingness or ability of small firms in the U.S. to cooperate where necessary to meet international challenges, ultimately lessens competition.

Second, whereas the Joint Research and Development Act was directed in no small part to collaborations between larger firms, and while the flexible enterprise networks of Europe frequently involve larger firms, the main constituents of networks are small, and often very small (micro) businesses which taken all together constitute no more than a small percentage of the applicable (almost-by-definition, fragmented) market.

Third, unlike joint ventures with their defined membership and activities, networks are better thought of as a course of dealing, an institutionalized communication between a large number of firms, which manifests itself in many different and shifting collaborations among a varying number of firms, for varying time periods, and varying activities. Networks are often informal, not consisting of a self-conscious defined membership, or a defined set of activities, or even a governing written contract. Perhaps my major finding since last testifying before some of you, is the extent of incipient network activity in the U.S. -- cooperative purchasing and marketing, joint technology purchases, informational meetings -- very little of which would be recognized by its participants as network behavior.

Finally, the flexible networks in Europe and the U.S. are not restricted to manufacturing. Indeed, perhaps the best example of an operating US

network is the film industry, with its shifting arrays of small independent firms converging to make individual films. Is the film industry a manufacturing or a service industry? Indeed, is IBM a manufacturing or a service industry? Is collaboration any less important in one than the other?

With this backdrop in mind, let me suggest some modifications to the legislation as currently proposed, that I think will help it better achieve its aims.

Recommendation 1: Add a statement of findings and purpose. Such a statement should acknowledge the relevant changes in the economy -- globalization, shortening product lifecycles, the new interplay between economies and diseconomies of scale and scope -- that affect the nature of competition; the contribution networks can make to increasing competitiveness and standard of living; and clarify that the goal of the act is to increase collaboration as a means to improve the general business practice in the country. Such a statement can guide interpretation of the act, and help prevent some of the unintended negative consequences noted below.

Recommendation 2: Remove the limitation to manufacturing. While manufacturing has some characteristics that make it particularly important to modernize, among them high wages, multipliers, exports and competition, services face many of the same challenges, can realize many of the same benefits from network collaboration, and are often difficult to distinguish from manufacturing. This would suggest changes in bill title and language, but the emphasis of the bill, and its impact, would likely remain in manufacturing.

Recommendation 3: Expand the definition of "flexible manufacturing network" included in Sections 2(a)Paragraph 7 and 2(b). I would suggest 1) changing the name to "flexible enterprise networks" or "flexible small business networks" and remove the limitation to manufacturing as noted above; 2) adding a paragraph F to Section 2(a) which allowed "other collaborative practices designed to increase the competitiveness of participating firms which does not involve price-fixing or restraint of trade"; 3) removing the proscription on exchange of information on marketing and distribution included in Paragraph 2(b); and 4) adding to 2(b)(2) a requirement that networks be open to all firms willing to pay their fair share of the costs. If the networks are to develop in this country with the speed and extent to help improve our competitiveness in a meaningful period of time, then one of the purposes of this legislation must be to invite firms to participate; without sacrificing the protections of Paragraph 2(b), the

protections of Paragraph 2(b), the bill must clearly encourage collaborative behavior.

Recommendation 4: Create a safe harbor for networks involving firms not representing more than 20% of the relevant mature international markets. Collaboration between small firms entering new markets (under 7 years old) should also fall under the safe harbor. I recognize the difficulty of defining markets, especially in today's economy, but measures, however imperfect, do exist and might be used and refined. I know of no other way to give protection and invite participation by the large number of small firms who will not even necessarily be aware of or able to be sufficiently definitive about their participation in network activity, and will have difficulty bearing the costs of a formal application. Clearly, there is some percentage of the market below which collaboration among firms cannot be construed to constitute an unfair threat to competition. Such a safe harbor was arguably unnecessary in the case of defined R&D joint ventures among larger firms, but it is necessary here.

New market niches are being defined and filled all the time as old mass markets fragment; definition and penetration of these new markets, especially by new and small firms is something we should encourage. While there may be only a few entrants into these markets initially, entry represents a broadening of competition, and collaboration here is particularly desirable as it spreads both the capacity and benefits of new market development.

Recommendation 5: Specify that the competitive benefits of networks be considered first in applying the rule of reason standard. This follows the formulation of the National Cooperative Research Act of 1984. Some specific benefits to be considered should be enumerated, or those cited in a statement of findings and purpose could be cited by reference.

Recommendation 6: Clarify that failure to file a notification should in no way prejudice participants in a network in an antitrust challenge. My greatest fear is that the proposed legislation, in providing a certification process for protecting conscious and defined collaborative behavior, will inadvertantly increase the jeopardy and penalties for the much broader -- and in the long run, arguably more important -- informal collaborative activities of smaller firms. If this happens, we will have won the battle by losing the war. The rule of reason standard, if not the lessened

standard, if not the lessened damages, should be applied in all challenges to small firm network activity.

I believe all the above recommendations are in the spirit of the proposed bill, and would help it achieve its purposes. Admittedly, the amorphous nature of networks, as well as the rapidly changing nature of the global economy pose stiff challenges to all who would attempt to craft antitrust legislation to achieve its traditional and still laudatory aims, and the real challenges and opportunities of today's economy. I would be happy to assist the Subcommittees in the drafting of specific language if you deem it desirable.

c. The Registration Procedure Fails to Provide Effective Protection from Antitrust Exposure

While the NCRA's elimination of treble damages for registered ventures is an important step forward, cooperating firms are still not protected from antitrust litigation. The cost of defending antitrust suits is not materially reduced by the exceedingly narrow circumstances in which the Act permits an award of attorneys' fees to prevailing defendants.[144] Moreover, single damages are still available. We believe that if an approval procedure existed under which procompetitive arrangements could obtain exemptions from further antitrust exposure to private damage actions, then many more competitively beneficial ventures would utilize the NCRA.

3. *REGISTRATIONS UNDER THE NCRA ARE DISAPPOINTING BUT NOT SURPRISINGLY LOW*

Businesses seem to have recognized the limited nature of the steps taken by the NCRA. Only 111 separate cooperative ventures registered under the NCRA between 1984 and June 1988. We have attempted to classify these according to the field of endeavor of the contemplated cooperation,[145] aggregating filings into the categories identified in Figure 3.

144. 15 U.S.C. § 4304(a) (Supp. 1986). Prevailing antitrust plaintiffs have long been able to recover their attorney fees. 15 U.S.C. § 15 (1982). Rather than treat prevailing defendants in like fashion, the NCRA permits prevailing defendants to recover attorney fees if the plaintiff's suit challenging the cooperative R&D venture is found to be "frivolous, unreasonable, without foundation or in bad faith." 15 U.S.C. § 4304(a) (Supp. 1986).

We propose symmetrical fee shifting provisions that permit the prevailing party -- plaintiff or defendant -- to recover attorney fees. *See infra* Section VI.C.2.c.(4).

145. The purposes of cooperative endeavors registered under the NCRA are published in the *Federal Register*. We have classified these registrations by referring only to the information described in this source.

Figure 3

Registration of Cooperative Endeavors Under The National Cooperative Research Act[146]

January 1985 - June 1988

Categories[147]	*Number*	*Percent of Total*
Advanced Materials	4	3.6
Biotechnology	3	2.7
Energy	10	9.0
Environmental, Health, and Medical	33	29.7
Information	33	29.7
Manufacturing	28	25.2
Total	111	100

Several observations should be made. First, the number of registrations is small. Second, we have the impression that most of these are very modest endeavors. At least one pre-existing and substantial entity, Bellcore, has registered under the NCRA, but with the exception of MCC and the SRC (discussed earlier), we believe that most of the endeavors operating under the Act have budgets of less than $5 million per year. Third, we are struck by the total number of endeavors aimed at solving environmental and health problems -- about 30 percent of the total non-redundant registrations. The Motor Vehicle Manufacturers Association, for instance, has 15 endeavors dealing with research on diesel emissions, benzene emissions, acid rain, long-range transport of air pollutants, and vehicle side impact test procedures. In short, the NCRA appears to have been employed largely for endeavors aimed at solving industry problems that are not of great competitive moment.

146 As published in the *Federal Register*, January 1985–June 1988 inclusive. We have excluded notification of membership changes. The total number of registrations would otherwise be 80.

147 Author's categories. Classifications are based on limited data and may not be accurate.